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Small Retailers
COALITION

Bill Douglass
Chairman
Small Retailers Coalition
PO Box 35537
Washington, DC 20033

February 21, 2017

Via Overnight Mail

Scott Pruitt
Administrator
Office of the Administrator
U.S. Environmental Protection Agency
Mail Code 1101A
1200 Pennsylvania Avenue, N.W.
Washington, DC 20460

Sarah Dunham
Acting Assistant Administrator
Office of Air and Radiation
U.S. Environmental Protection Agency
Mail Code 6101A
1200 Pennsylvania Avenue, N.W.
Washington, DC 20460

Re: **Comment for Docket: EPA-HQ-OAR-2016-0544 - Request to change the point of obligation in the Renewable Fuel Standard to the rack**

Dear Administrator Pruitt:

The Small Retailers Coalition appreciates the opportunity to provide comments regarding the United States Environmental Protection Agency's Proposed Denial of Petitions for Rulemaking to Change the RFS Point of Obligation. In addition to the comment letter (entitled "Small Retailers Coalition comments Final 02-20-2017), we are providing a complete set of numbered reference and supporting documentation, in addition to supplemental materials.

Very truly yours,

Bill Douglass

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February 20, 2017

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Re: **Comment for Docket: EPA-HQ-OAR-2016-0544 - Request to change the point of obligation in the Renewable Fuel Standard to the rack**

Dear Administrator Pruitt and Acting Assistant Administrator Dunham:

My name is Bill Douglass and I am the Chairman of the Small Retailers Coalition ("SRC"). I am writing to submit formal comments to the docket number above on behalf of the SRC. I am writing to beseech you to reconsider your Proposed Denial of Petitions for Rulemaking to Change the Renewable Fuel Standard ("RFS") Point of Obligation. Changing the point of obligation in the RFS is critical to the survival of small, single-store owners and medium-sized gas stations and convenience stores, which, together, comprise approximately 75 percent of the retail fuel market in the United States.[1]

Let me underscore this: when EPA issued its Proposed Denial, it did not have the opportunity to consider any comments from 75 percent of the retail gasoline market most adversely impacted by the current point of obligation. In this action, we are providing you with a record to show that the current point of obligation is disadvantaging the vast majority of retailers in this nation and restraining fuel distribution in the Country.

This is not hyperbole. If the point of obligation is not moved to the position holder at the rack, the majority of small, single-owner gasoline stations in the United States will close or be bought out by mega-chains over the next 24 months.

In a presentation entitled "Shop Talk T.O.C. (Threats, Opportunities and Consolidation) in Mid and Downstream Fueling," the former CEO of The Cumberland Gulf Group projected

[1] *See* RETAIL FUELS REPORT at 3, NAT'L ASSOC. CONV. STORES (2016).

that the number of U.S. gas stations will drop from over 140,000 locations to a mere 115,000 sites. The reason is because:

> Due to the increasing acquisition of convenience store chains by master limited partnerships flush with available cash, the c-store industry will continue to consolidate.[2]

He expects the future will be highlighted by:

- 32 major U.S. c-store retailers operating 56,000 gas stations;
- 15 grocery/hypermarts with a total of 14,000 sites;
- Two mega distributors operating a combined 5,000 locations;
- 20 super distributors with 18,000 sites;
- Just 12,000 single-store operators, a large decline compared to today; and
- 10,000 unmanned locations.[3]

This sums it up. The current point of obligation benefits large corporate entities and pushes small gas stations out of the market. This is purely a by-product of EPA's regulation dictating that the obligated parties are only the refiner or importer. EPA has created a government program that subsidizes the largest corporations in America and closes small businesses.

We know this is clearly not what EPA intended. EPA is trying to implement its Congressional mandate to get more renewable fuels into the marketplace. The RFS is not supposed to cut off distribution chains; instead, it is supposed to increase them.

We are the bulk of the fuel distribution in this Country. Don't shut us down.

Who We Are

Before I offer data to show how the current point of obligation is putting us out of business, I wanted to share with you who "we" are.

The Small Retailers Coalition is a 200-plus member organization made up of small- and medium-sized gas station and convenience store owners. The SRC was formed exclusively to help our members advocate to EPA, the White House, and state and federal legislators to educate them on how the current point of obligation is closing small businesses at a record rate across the Country.

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[2] Brian Berk, *Threats, Opportunities & Consolidation in Fueling: Former Gulf CEO Joe Petrowski shares his outlook at SIGMA Annual Meeting*, Convenience Store News (Nov. 11, 2014), http://www.csnews.com/node/73727.

[3] Joe Petrowski, Presentation at SIGMA Nashville: Shop Talk T.O.C. (Threats, Opportunities, and Consolidation) in Mid and Downstream Fueling (Nov. 2014).

We had to form when our national trade associations refused to advocate for us because the current point of obligation creates a multi-billion dollar financial windfall for the large retailers that now control the vast majority of blending terminals across the Country. As such, the current point of obligation has created the largest transfer of wealth from small business to corporate America in history.

We are independent business owners, the majority of whom own one store. We have ties to our local communities. We are first-generation immigrants and we are from families who have lived in our communities for generations. Many of us are minority business owners who are trying to live the American Dream and make it in a small business. This is why groups like "Empower Consumers"[4] sent a letter to EPA asking to "Please Fix the Renewable Fuel Standard." That letter (included as part of our record) lays it out pretty clearly:

> What's wrong with a few big gasoline retail chains enjoying extra profits generated by the RINs they sell on the market? Well, nothing—if you're one of those chains. But if you happen to be an independent gasoline retailer (many of which are minority-owned) whose competition up the street is suddenly sitting on a pile of cash, it's not so great. It means your competitor's parent company has a newfound ability to spend money on buying up stations, or making their stations look more appealing than yours. Whatever they do, it's not helpful to a small business earning a living as an independent gasoline retailer.[5]

They were joined by a resolution from the National Black Caucus of State Legislators (included as part of our record) urging EPA to fix this market injustice:

> THEREFORE BE IT RESOLVED, the National Black Caucus of State Legislators (NBCSL) calls on the U.S. Environmental Protection Agency to adopt a rule to address problems in the RINs market by moving the point of obligation in order to eliminate incentives for excessive speculation and fraud.[6]

Why We Can't Compete

The reason that small retail gas stations cannot compete fairly in the current market is because the current point of obligation is removed from the rack—that is, the bulk terminal or truck loading terminal where entities control whether gasoline is blended. The large retailers now largely control these terminals and can decide who gets positions at the rack. As a result,

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[4] *See Our Mission*, EMPOWER CONSUMERS, http://www.empowerconsumers.org/about-us/our-mission/ (last visited Feb. 20, 2017).

[5] Letter from Daryl Bassett, Chairman, Empower Consumers, to EPA, *EPA, Please Fix the Renewable Fuel Standard*.

[6] Resolution BED-17-15, Nat'l Black Caucus of State Legislators (Dec. 3, 2016), *available at* http://nbcsl.org/index.php/public-policy/resolutions/item/download/641_91cd4a86fcb96e5427d499b14bb42470.

large retail conglomerates are able to purchase gasoline unobligated and then blend it with ethanol or biofuels at the rack to generate a Renewable Identification Number ("RIN").

These large retailers then sell the RIN to obligated parties and generate enormous windfall profits. This allows our large retail competitors to have a direct price advantage over small- and medium-sized retailers that I and other small/medium-sized retailers cannot match because we cannot blend fuel at the rack.

Small retailers have to purchase blended fuel at a premium. So, the base cost of my product is already higher than the cost to my large competitors that can blend fuel. This is a market reality that we can address through innovation and other marketing incentives. What we cannot overcome is that my largest competitors also get a $.10 to $.15 per gallon subsidy for selling the RIN to obligated parties. They are then able to use this profit to roll up small businesses.

Again, here is why the current point of obligation should be changed to the rack:

1) The current point of obligation gives large retailers a $.10 to $.15 per gallon advantage over small and medium suppliers that is unfair, anti-competitive, and creating an oligopoly in the retail fuel sector;

2) The large retailers, who are able to purchase gasoline unobligated, sell the RINs for a profit. They make such a significant percentage of their profits from RIN sales for E-10 that they have no incentive to invest in infrastructure to support the further penetration of renewables in the market place.

Small and medium retailers make up over 75 percent of the retail gas stations in this Country, but we have been abandoned by our trade associations like NACS, SIGMA, and NATSO. On the issue of the point of obligation, these associations have sided with the mega-distributors in our industry because they pay the lion's share of dues. As our V.P. and Treasurer Stanley Roberts says about the mega-distributors: "They don't outnumber us, they just out-money us!"[7]

Let me be clear: NACS, SIGMA, and NATSO DO *NOT* REPRESENT THE INTERESTS OF SMALL RETAILERS ON CHANGING THE POINT OF OBLIGATION. As a former Chairman of the Board of NACS, this personally saddens me. These organizations have historically served us well and continue to provide some valuable services for small and medium retailers, but on this issue, they have abandoned us for the biggest dues payers.

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[7] See *Small Retailers Coalition – RINs, the RFS, and EPA*, YOUTUBE (Dec. 21, 2016), https://youtu.be/Fpert_VSPOg for a video description of how the current point of obligation impacts small retailers.

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We Need EPA to Act

Small and medium retailers have nowhere else to turn but to EPA. I ask you to please look at the market facts and consider them in your review of the underlying Petition. The only retailers that EPA cited in its Proposed Denial are the very retailers that get the windfall from the RIN without any obligation to the RFS.

The SRC and other small retailers were not able to provide facts and data in the original record because we did not exist as an organization at the time the Petition was filed. This is an issue of economic survival for us, and one that EPA has an obligation to correct in the rule by aligning the point of obligation with the point of blending at the rack. This simple, but critical, fix would minimize the economic burdens to small retailers and maximize the effectiveness of the RFS program.

The RFS program was designed to drive the market towards selling renewable fuels available in the marketplace, not to drive small- and medium-sized retailers out of business. We know that EPA does not intend to put such businesses in jeopardy across the country, and that there are other issues that EPA must contemplate in the RFS program. Moving the point of obligation, however, is a simple step that EPA can take to level the playing field for all gasoline retailers while allowing EPA to meet the goals that Congress laid out by eliminating this market barrier and protecting and maximizing the fuel distribution system in this Country.

Respectfully, here are the factors that EPA did not consider in its Proposed Denial:

1) EPA has not satisfied its statutory obligations to consider the economic impacts of the RFS and the point of obligation on the small retailers when it promulgated the RFS2 in 2010 and the implementing regulations for the point of obligation.

   EPA has stated before the D.C. Circuit Court of Appeals that it believes "the proper place to seek to change the point of obligation" is this Petition.

   As such, this is the vehicle through which EPA can correct the deficiency in the previous rulemaking process and "minimize the significant economic impact on small entities" by promulgating an alternative that will not disadvantage small businesses and provide a level playing field for all by changing the point of obligation to the rack.

2) The current point of obligation in the RFS program has resulted in and will continue to result in the decreased "distribution" of renewable fuels in the United States. As such, EPA has an obligation to lift this market impediment to maximize distribution outlets for renewable fuels and consumer choice.

1. **EPA has a statutory obligation to minimize the economic impact of the RFS on small entities. This can be satisfied by granting the Petition.**

The Regulatory Flexibility Act ("RFA"), 5 U.S.C. §§ 601–612, as amended by the Small Business Regulatory Enforcement Fairness Act ("SBREFA"), ***requires*** federal agencies to consider potential impacts of their rules on small entities. Under the RFA, agencies ***must*** conduct a regulatory flexibility analysis to analyze possible effects of a proposed rule on small businesses, unless the agency certifies that the "rule will not, if promulgated, have a significant economic impact on a substantial number of small entities." 5 U.S.C. § 605(b).

Where a rule is anticipated to have significant economic impacts on a substantial number of small entities, the RFA's provision governing preparation of a final regulatory flexibility analysis, 5 U.S.C. § 604, requires that the agency provide a description of the steps it has taken to minimize the significant economic impact on small entities consistent with the stated objectives of applicable statutes. This includes a statement of the factual, policy and legal reasons for selecting the alternative adopted in the final rule and why each one of the other significant alternatives to the rule considered by the agency which affect the impact on small entities was rejected. 5 U.S.C. § 604(5).

Further, EPA's guidance to its staff when drafting rules clearly dictates that:

> [Y]ou should analyze who is subject to the requirements of the rule even if the rule is either not immediately enforceable or does not impose immediately applicable requirements on those subject to the rule. You should perform this analysis as long as you know (1) who will be regulated; and (2) what requirements will be imposed.

Despite the fact the RFS2 explicitly states that it applies to "Entities . . . involved with *distribution and sale of transportation fuels, including gasoline and diesel fuel, or renewable fuels such as ethanol and biodiesel,*" EPA never did *any* analysis whatsoever on the effects of the RFS and the designation of obligated parties on retailers. It's not that the analysis is insufficient; it is non-existent. This procedural defect in the rule should be addressed and corrected in EPA's response to this Petition, as agencies have done historically when remedying a flawed rulemaking process.[8]

This failure to even consider the significant economic impacts of the RFS2 on small retailers is a procedural deficiency, which, as a defect in the flexibility analysis, can be grounds for a court to strike down the rule. The statutes do not dictate that EPA has to draft rules in a certain way, but it is clear EPA must perform the required analysis of the economic impact of its

[8] *See, e.g., Aeronautical Repair Station Ass'n, Inc. v. F.A.A.*, 494 F.3d 161 (D.C. Cir. 2007); *Nat'l Ass'n of Home Builders v. U.S. Army Corps of Engineers*, 417 F.3d 1272 (D.C. Cir. 2005) (resolved by partial consent judgment); *Thompson v. Clark*, 741 F.2d 401 (D.C. Cir. 1984); *Nw. Min. Ass'n v. Babbitt*, 5 F. Supp. 2d 9 (D.D.C. 1998); *S. Offshore Fishing Ass'n v. Daley*, 995 F. Supp. 1411 (M.D. Fla. 1998).

regulations on small businesses impacted by the regulations. Failure to perform such an analysis or performing a substandard analysis of the impacts has led to remand of the rule in question or a resolution by the government that eliminated the "significant economic impact" on small entities.

EPA itself states in its Proposed Denial that it recognizes that "in any rulemaking to modify the RFS point of obligation, EPA would need to consider the impacts on small entities, as it did in prior rulemakings." We agree! Please DO! EPA has never considered the effects of the RFS on small retailers as blenders in its SBREFA analysis in the historic or current rulemakings under the RFS. EPA has only considered the impacts on small refiners.

So, it is unacceptable that EPA is willing to abdicate its statutory responsibility and shut down potentially 60 percent of the fuel distribution in the United States because it hypothesizes that the "RFS market would experience significant uncertainty in such a transition."

This deficiency must be corrected and can be in EPA's response to this Petition. EPA has stated that "[t]he proper place to seek to change the point of obligation is a petition to reconsider."[9] Again, we agree!

In the Proposed Denial, EPA completely left out all analysis of the extreme market impact on small retailers and based the Proposed Denial almost exclusively on a letter submitted by retailers who financially benefit from the unobligated sale of the RIN. Of course these retailers oppose moving the point of obligation! They get a generous government subsidy that small business cannot access. How can we compete?

We can't.

Even if EPA does not care about shutting down almost 100,000 small businesses, Congress directed EPA to care about maximizing the distribution outlets for renewable fuels. EPA states in the Proposed Denial that "changing the point of obligation is not expected to significantly impact the retail pricing of fuel blends with high renewable content." This may or may not be true. As we all acknowledge, there are many variables that go into fuel pricing. But, what EPA overlooks is that regardless of price, the availability of all fuels will drop dramatically because retail outlets are closing due to the RIN doubling the fuel margins of the few select stores.

In its Proposed Denial, EPA also overlooks the market reality of what consumers want and will pay a premium for. In a market where 75 percent of the retailers are consistently undercut $.03 to $.15 a gallon on renewable fuels, they will offer alternatives like clear gasoline or E-0. There is a rising demand for clear gas in the market[10] and consumers will pay an average

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[9] Brief for Respondent EPA, *Americans for Clean Energy v. U.S. Environmental Protection Agency*, No. 16-1005, at *119 (D.C. Cir. Dec. 15, 2016), Doc. No. 1651336.

[10] *See* Carlton Carroll, *Consumer Demand for Ethanol-Free Gasoline is Strong and Rising*, API (May 20, 2015), http://www.api.org/news-policy-and-issues/news/2015/05/20/api-consumer-demand-for-ethanol-free-gas.

of $.25 a gallon more for E-0 than they will for E-10. This is pushing the market in the opposite direction of what the RFS mandates.

2. **The current point of obligation in the RFS program has resulted in and will continue to result in the decreased "distribution" of renewable fuels in the United States. As such, EPA has an obligation to lift this market impediment to maximize distribution outlets for renewable fuels and consumer choice.**

> In its brief to the D.C. Circuit Court of Appeals, EPA laid out that:
>
> EPA has explained time and again in its annual renewable fuel standard rulemakings, this increased use of renewable fuels over time requires private parties to invest in production facilities and infrastructure to accommodate such fuels. *E.g.*, 80 Fed. Reg. at 77,453, 77,459-60. Annual reconsideration of the definition of obligated parties would reduce the regulatory certainty required for private parties to plan for growth.[11]

While we support the argument that EPA has an obligation to review the point of obligation and other factors in the RFS annually to accurately capture market trends, we also appreciate that EPA's overall charge is to increase the distribution of renewable fuels into the marketplace. Common sense would dictate that this means investment in infrastructure to distribute the fuels.

In the Proposed Denial, EPA relies on letters from mega-retailers that profit from the RIN which maintain that these large companies use the RIN profits to invest in infrastructure for renewable fuels and pass on the value on the RIN to consumers. This simply is not true. These conglomerates are using the windfall from selling RINs to make infrastructure investment in their operations or to roll-up small, independently owned gas stations. They do not use the value of the RIN to increase the volumes or concentrations of renewable fuels to consumers.

Here is how the giant corporate chains use the RIN. First, these mega-distributors use the RIN proceeds to artificially lower the cost of fuel just enough to undercut the competition that cannot enjoy the RIN—usually from $.02 to $.03 a gallon. They DO NOT pass on the value of the RIN to consumers. Instead, they just use a small portion of it to consistently underprice gasoline at the pump in order to drive small retailers out of business. (For a detailed discussion of how this occurs, please see pages 7–9 of the Amicus brief filed by the SRC in the D.C. Circuit Court of Appeals, which is attached in this submission.)

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[11] Brief for Respondent EPA, *supra* note 9, at *113.

Next, once the small retailers are distressed, the mega-distributors offer to buy the single owner stores. This DOES NOT increase the number of pumps for distribution. The standards formula that mega-chains use is that for every store they open, they close five competitors![12]

Don't take our word for it. Take theirs. The mega-distributors that sell RINs for profit may make claims in letters to EPA that RINs don't impact their bottom line and that they use profits to develop infrastructure for renewables. But they tell their shareholders a very different story in SEC filings and earnings calls.

For the sake of brevity, I have excerpted several quotes from public SEC filings, press releases, and earnings calls. (Along with these comments we will submit copies of the documents for your reference.)

Murphy's

- 2017-02-01 – Q4 2016 Press Release
  - "On a combined basis, PS&W and RINs effectively contributed 4.83 cpg to retail margins in the fourth quarter and 3.85 cpg for the full year." (page 2).
- 2016-11-03 – Form 10-Q
  - "[O]ur cost of goods sold is impacted by our ability to leverage our diverse supply infrastructure in pursuit of obtaining the lowest cost fuel supply available; for example, activities such as blending bulk fuel with ethanol and bio-diesel to capture and subsequently sell Renewable Identification Numbers ("RINs")." (page 28).
  - "In recent historical periods, we have benefited from our ability to attain RINs and sell them at favorable prices in the market." (page 28).
- 2016-11-03 – Q3 2016 Earnings Call
  - "Improvement in product supply and wholesale contribution, net of RINs, recovered almost half of the decline in the retail fuel contribution. Together, these two components added $0.0175 per gallon on a retail equivalent basis versus a negative $0.022 per gallon contribution last year. RIN sales of $48 million offset product supply and wholesale contribution of negative $29 million, as higher RIN prices embedded in the refinery spot

[12] *See, e.g., Texas Continues to Lead U.S. C-store Count: Industry finds fewer single-store owners are selling fuel*, CONVENIENCE STORE NEWS (Feb. 3, 2017), http://www.csnews.com/industry-news-and-trends/corporate-store-operations/texas-continues-lead-us-c-store-count; Catherine MacMillan, *Truck Stops: Reviews, Trivia and Features of the North American Chains*, SMART TRUCKING (Aug. 8, 2016), http://www.smart-trucking.com/truck-stops.html; Citizens Commercial Banking, Consolidation in the Convenience & Retail Fuel Sector: Strategies for Capturing Value (2015);

prices reduced our spot to wholesale rack margins, which stayed negative for much of the quarter." (page 4).

- "While the net contribution is expected to be above guidance, the product supply and wholesale results alone will be below the $25 million to $45 million range, while RINs sales will exceed the $0.30 to $0.50 per-RIN range we guided to. Since RIN prices are essentially embedded in the refinery spot prices, investor focus should remain on the net contributions." (page 5).

- "[W]e're going to continue to report RINs and other income just like refiners report the cost of it separately. I gave a real clear example of how it nets off against our piece, and it's still going to be in that $0.025 to $0.03 range. The refiners have that built into their refinery margin. They just like to call out the cost separately. And I appreciate that refinery margins are now at a very low point again, but that's largely due to the refinery economics, the excess product, the high utilization and the more macro factors, and not really about RINs." (page 15).

- 2016-08-04 – Q2 2016 Earnings Call

  - "[P]eople shouldn't get overly excited in our earnings if RINs are at $0.90 versus $0.50 because you see that impact in the trade-off because spot prices are higher, and that is something, I think, the EPA and RSS anticipated." (page 8).

- 2016-05-09 – Q1 2016 Earnings Call

  - "But then you've got the regulators who will be announcing, hopefully by the end of May, their proposal for the RFS ethanol mandates for 2017. Then those are enacted in November. So depending on whether or not they ratchet up the ethanol mandate or not, that benefit of balancing the supply/demand of RINs may be short-lived if they decide to raise the mandate further." (page 10).

- 2016-03-08 – Raymond James 37th Annual Investors Conference Presentation

  - "So what's the differentiated capability that sets us apart? It's our fuel supply chain. And the way we do that is 50% of the gallons we sell are sourced through proprietary barrels, meaning we buy them from the refiners in the refining centers, we ship them through the pipeline systems for which we have access through our historical shipper status. And that takes decades to build. If you wanted to get in this business tomorrow, you could not go and get pipeline access on most of these pipelines. We take that into mostly third-party terminals. We blend it with ethanol. That captures the RIN. And that leaves us with a landed cost of supply when you add that supply advantage plus the RINs, that's going to be advantaged over our competitors." (page 4).

- "We have access to the RINs through the blending. We have the credit. We have the scale and scope to hold the working capital and manage through the volatility that smaller competitors don't have." (page 5).

- 2016-02-26 – Form 10-K (FY 2015)
  - "[W]e believe our business model provides additional upside exposure to opportunities to enhance margins and volume. For example, incremental revenue is generated by capturing and selling Renewable Identification Numbers (RINs) via our capability to source bulk fuel and subsequently blend ethanol and bio-diesel at the terminal level." (page 3).
  - "[O]ur revenues are impacted by our ability to leverage our diverse supply infrastructure in pursuit of obtaining the lowest cost of fuel supply available; for example, activities such as blending bulk fuel with ethanol and bio-diesel to capture and subsequently sell Renewable Identification Numbers ("RINs")." (page 30).
- 2016-02-04 – Q4 2015 Earnings Call
  - Murphy is a "major beneficiary of RINs with our proprietary supply chain." (page 3).
  - "RINs, of course, are a source of strength in the PS&W portfolio, given our ability to ship over 50% of our retail barrels and blend the ethanol ourselves." (page 6).
  - "If you dial back your wholesale and then dial back your shipping, you would ultimately start losing that line space, which is a critical advantage, which also allows you to capture the RINs. So, again, there is some interplay there driven by the market dynamics." (page 10).
- 2014-12-31 – Investor Update Presentation
  - "RIN prices elevated, so refiners motivated to sell ethanol blends from terminals" (page 15).
  - "Bottom Line: Elevated RINs accelerates rack price declines" (page 15).

Casey's

- 2016-12-08 – Q2 2017 Earnings Call
  - "The second quarter margin benefited from the sale of renewable fueled credits, commonly known as RINs. During the quarter we sold $17.8 million RINs or a total of $15.9 million. This represented about $0.03 per gallon improvement to the fuel margin.

RINs are currently trading around $1.12. For comparison purposes, going forward, last year in the third quarter, the average RIN sold was approximately $0.61." (page 2).

- "[W]e're fortunate I would say to be able to benefit from [the point of obligation] and due to our market, where we operate and the way we distribute our fuel." (page 7).

- 2016-12-07 – 10-Q (for quarter ending October 31, 2016)
  - "The Company sold 17.8 million renewable fuel credits for $15.9 million during the quarter, compared to 13.6 million fuel credits in the second quarter of the prior year, which generated $4.7 million." (page 12).

- 2016-09-07 – Q1 2017 Earnings Call
  - "Fuel margin was up about $0.02 per gallon from the first quarter of last year due to a decline in the wholesale cost of fuel and a favorable environment for renewal energy credits resulting in a fuel margin of $0.195 per gallon for the quarter. During this time, we sold approximately 17.9 million RINs at an average price of $0.82. This represented about $0.027 per gallon benefit to the fuel margin." (page 2).

- 2016-09-06 – 10-Q (for quarter ending July 31, 2016)
  - "The gross profit margin per gallon increased (to $0.195) in the first quarter of fiscal 2017 from the comparable period in the prior year ($0.175) primarily due to elevated RIN values as well as a declining wholesale fuel cost environment in the current year." (page 13).

- 2016-06-27 – 10-K (for fiscal year ending April 30, 2016) & 2016 Annual Report to Shareholders
  - "While the new volume requirements are lower than those originally set by Congress, we believe they could add support to renewable fuel credit values for the next several years." (page 12 of the Annual Report).

- 2016-06-06 – Press Release - Q4 2016 - Casey's Finishes Year with Record Earnings
  - "The Company sold 12.7 million renewable fuel credits for $9.1 million in the fourth quarter. . . . The fuel margin remained strong throughout the year, aided in part by favorable renewable fuel credit values." (page 1).

- 2016-03-07 – Press Release - Q3 2016 - Casey's Posts 28% Increase on Year-To-Date Net Income
    - "Fuel margins finished above goal for the third quarter due to elevated RIN values as well as a decline in wholesale fuel costs towards the end of the quarter." (page 1).

Couche-Tard

- 2016-11-22 – Q2 2017 Earnings Call
    - Speaker: Brian Hannasch, CEO; Hannasch: "In the U.S., we buy under a variety of structures including some where we get full RIN economics and some where we get partial RIN economics. From our standpoint it's impossible to quantify as you can never tell and I don't think anyone can tell how much is priced in any given rack, at any given time, which is how most of the industry would purchase fuel. However, if it does go away, it goes away for everyone and the markets will adjust and we'll focus on other ways to again establish and widen our competitive advantages on how we purchase fuel. That said, this rule cannot be changed by executive order. It does take full-blown rule making and judicial review for this rule to be changed, and from our perspective and the people we're talking to there's significant and very strong opposition by the American Petroleum Institute, all the major marketing groups, some of the automotive companies and the ethanol producers. So we're watching the issue closely. Again, it's difficult to quantify but at this point we're not overly concerned with the RIN issue." (page 6).

- 2016-08-30 – Q1 2017 Earnings Call
    - Speakers: Brian Hannasch, CEO & Claude Tessier, CFO; Tessier: "We got generally broader access to RINs in the U.S. than most of our competition. So as RINs increase in value we think that widens our competitive advantage and then finally we focus on the Categories. So we think we were widening what we believe it's a key competitive and sustainable advantage in the fuel space." (page 5).
    - Hannasch: "[W]e believe it's impossible to pinpoint exactly the value of RIN. It requires making assumptions about how much of the RIN value makes into wrap [ph] prices and another competitor deals and there is just no way of knowing of that. That said, we focus on having better supply deals than our competition and we think ACT on average has better access to RINs in the overall market. So as RIN values increase we think the advantages we have of having access to those RINs widens our supply advantage vis-à-vis competition, so in general we do like having a higher value RIN." (page 11).

- 2016-07-13 – Q4 2016 Earnings Call
    - Speaker: Brian Hannasch, CEO; Hannasch: "I think in our situation with our scale, I think we're in a position that we're able to capture a greater proportion of the value of the

RINs across our footprint than most of our competitors. So while it's hard to quantify the exact impact, we think we're advantaged vis-a-vis the industry when it comes to RINs, and that a higher RIN value is actually a positive for us vis-à-vis the industry, which is what I think is relevant. I'd also point out, we don't speculate on RINs. We do not try to pretend to know what direction they're going. So as we receive them, we sell them. So you shouldn't see a significant financial impact from a holding period on RINs." (page 9).

We know that EPA is sophisticated about how the market works, and clearly acknowledges in its justification for exercising its waiver authority that "the RIN is currently an inefficient mechanism for reducing the price for higher level ethanol blends at retail, and therefore unlikely to be able to significantly impact the supply of ethanol in the United States in 2016." 80 Fed. Reg. at 77,457.

This is illustrated perfectly by Murphy's in an investor presentation on March 21, 2016, in which it lays out exactly how it uses the RIN to increase fuel margins. The entire presentation is attached to these comments, but the chart below shows that the large retailers that capture the RIN add it to their bottom line. What's more, the large retailers make these huge profits on selling RINs for E-10, not E-85. Why change? There is no incentive to blend higher percentages of renewables, but there is an enormous economic incentive to have the E-10 blend wall broken so RIN prices move even higher. This is happening, and EPA acknowledges this in its justification for using waiver authority.

PS&W plus RINs consistently adds to total fuel contribution

1) CPG based on retail volumes, before corporate overhead

This is further supported in a recent study by Ramon Benavides, President of Global Renewable Resources.[13] The study is attached as part of the record with this comment. Benavides analyses the ways in which large retailers are able to double their margins by selling RINs. The paper focuses on Pilot/Flying J and Love's because of the considerable amount of information they make public. But it is not an indictment of those companies; it is simply a study of what it happening in the retail market.

The study uses the Estimated Margin Indicator ("EMI") to ascertain fuel margins for the two companies. The EMI demonstrates that Pilot/Flying J and Love's margins exceed the National Association of Convenience Stores ("NACS") average of $.189 cents by nearly double. This is because these companies enjoy a strong financial advantage over companies that distribute and sell petroleum fuels. The ultimate effect could be selective losses in market share for smaller, less sophisticated market participants.

Benavides concludes:

> While the entire EMI is available in Appendix One, a summary of the results for both Pilot/Flying J and Loves follow. In both instances, these entities' combined gross profits are almost twice as high as the national average. Furthermore, a pass-through to customers did not occur, as additional RIN-derived margins are retained by large fuel retailers as profits. To the contrary, small fuel retailers, which do not have access to similar margins, are likely to lose market share as a result. If the Environmental Protection Agency ("EPA") were to alter the point-of-obligation under the Renewable Fuel Standard ("RFS"), small fuel retailers would be considerably more likely to be able to achieve price parity with large fuel retailers and sustain operations in local markets that continue to thrive based in substantial part on robust retail competition.

In our amicus brief to the D.C. Circuit Court of Appeals, we cited a report by Dr. Bernard L. Weinstein (Associate Director, Southern Methodist University Maguire Energy Institute) that supports these conclusions:

> The bias against small retailers has serious implications for their long-term survival because the current regulatory regime governing RINs trading allows large fuel marketers and large retailers to gain revenues and a competitive advantage over small retailers. Reports indicate that large retailers are using the RIN profit stream for retail expansion and acquiring a larger share of a limited market. Small retailers are losing both sales volume and stores to large retailers. In other words, small retailers aren't just less profitable but they

[13] *See* Ramon M. Benavides, Renewable Fuel Incentives: Estimation of Large Retailers' Margins (Feb. 2017), *available at* http://smallretailerscoalition.com/wp-content/uploads/2017/02/Renewable-Fuel-Incentives_Estimation-of-Large-Retailers-Profits.pdf.

> are going out of business due to their growing inability to compete with large retailers. As a result, the demise of small "mom-and-pop" fueling stations has accelerated, with more than 12,000 closing since 2007.[14]

Dr. Weinstein further updated his report in February of this year after reviewing EPA's Proposed Denial and analyzing the impacts that a denial would have on small retailers. He outlines in great detail how EPA's apathy here will drive small retailers out of business and creates a $30-billion-a-year incentive for unobligated blenders to blend E-10 and nothing more.

Our Plea – Grant the Petition to Move the Point of Obligation

The era of the large, non-obligated, RIN-rich retailer dominating the market is underway. If the EPA does not move the point of obligation to the rack, small retailers will have little choice but to close or sell-out to the non-obligated, RIN-rewarded large retailers. We hope that you take the information that we have submitted to heart, but we encourage you to also do your own research. Go out and ask retailers, small and large, for copies of their fuel contracts to see how the system really works. We are prevented by anti-trust laws from providing you our members' contracts, but you can get them. See what the market reality is particularly for the branded retailer. Please do not base your decision on the unsupported statements of the beneficiaries of the system.

America needs and depends on small and medium retailers for up to 75 percent of its fuel needs. Don't shut us down for the benefit of approximately 50 mega-companies. History shows that oligopolies are not good for distribution of goods or for customer choice. All we are asking is a level playing field upon which to compete.

I close by offering that I, or a member of the SRC, will come to Washington to meet, to answer questions and provide anecdotes or more market data. We will provide any additional information you need. Hopefully, several of our members will also write to you to share their personal stories. We want to sell renewable fuels! But the current point of obligation is simply closing us down.

Please stop this RINsanity and let us compete in a fair, unbiased market.

Very truly yours,

Bill Douglass

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[14] *See* Bernard L. Weinstein, Renewable Identification Numbers (RINS) Trading Under the Renewable Fuels Program: Unintended Consequences for Small Retailers 6 (Aug. 2016) (report for Southern Methodist University Maguire Energy Institute), *available at* http://smallretailerscoalition.com/wp-content/uploads/2016/08/SMU-Retailer-RINS-analysis-8-17-1.pdf.

Small Retailers
COALITION

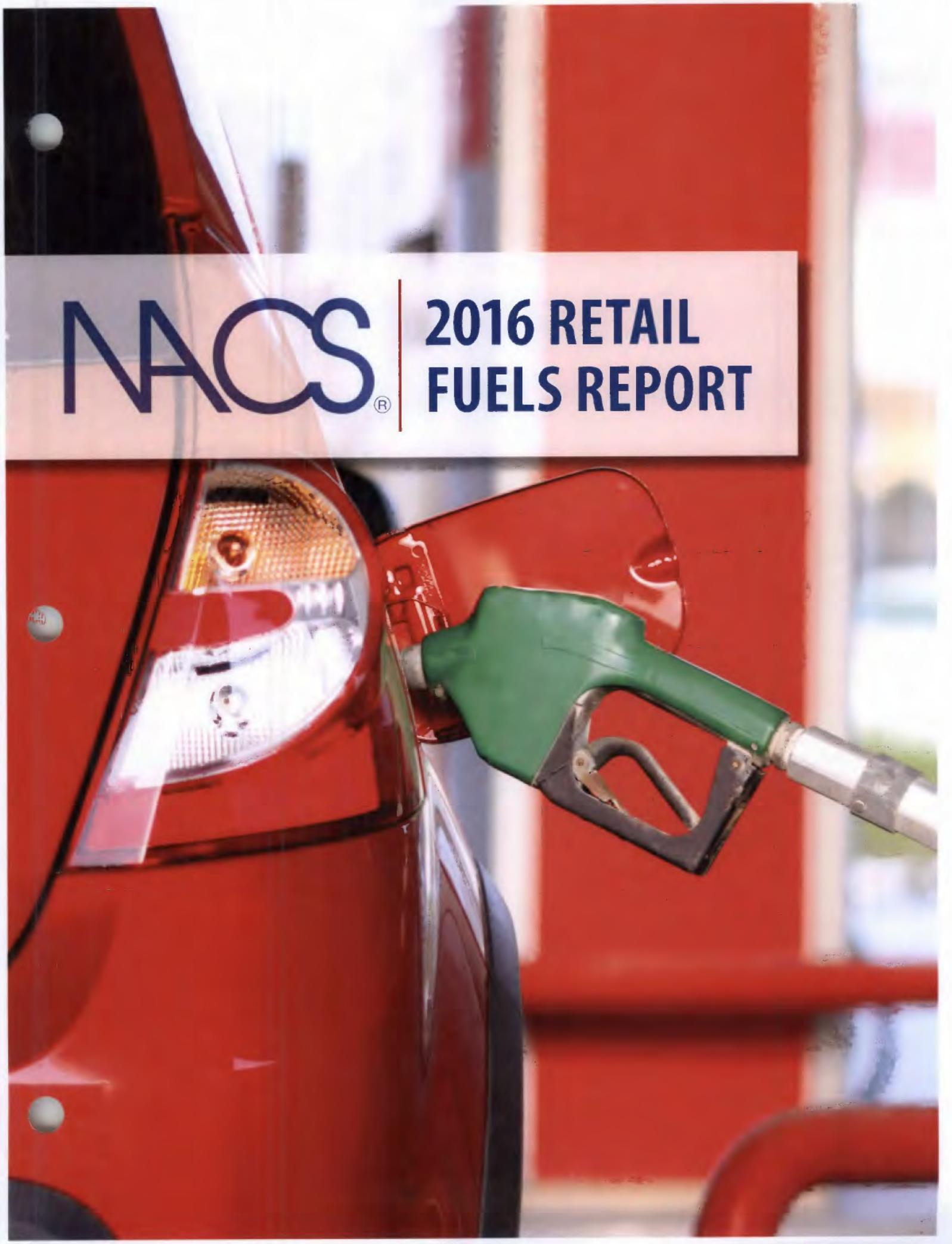
Bill Douglass
Chairman
Small Retailers Coalition
PO Box 35537
Washington, DC 20033

Re: **Comment for Docket: EPA-HQ-OAR-2016-0544 - Request to change the point of obligation in the Renewable Fuel Standard to the rack**

Cited References

Supplemental Materials

1. Douglass - Commentary - Small Retailers Penalized by Renewable Fuels Mess (10-6-16)
2. Goldman Sachs - Tighter RIN markets into 2017 create biofuel-refiner dislocations (6-29-16)
3. Letter from Bill Douglass to EPA Janet McCabe (7-28-16)
4. Letter from Bill Douglass to Small Retailers Coalition Members (8-15-16)
5. Lundberg Letter - Breaching the Blend Wall Again (9-27-16)
6. NACS Online - 2013 NACS Retail Fuels Report - Who Sells America's Fuel
7. SRC Response to NACS-SIGMA Letter to Congressional Committee Members
8. TheStreet - Casey's Posts Record First Quarter Earnings (9-6-16)


NACS®
2016 RETAIL
FUELS REPORT

NACS RETAIL FUELS REPORT

The NACS Retail Fuels Report, now in its 15th year, explains market conditions that affect gas prices—and what to watch for in 2016.

About NACS

NACS was founded August 14, 1961, as the National Association of Convenience Stores. The U.S. convenience store industry, with more than 154,000 stores across the country, posted $696 billion in total sales in 2014, of which $483 billion were motor fuels sales. NACS has 2,100 retail and 1,700 supplier member companies, which do business in nearly 50 countries.

NACS serves the convenience and fuel retailing industry by providing industry knowledge, connections and advocacy to ensure the competitive viability of its members' businesses. The association serves as the industry's voice in the federal government and its issues are as varied as the industry it represents, from swipe fees to motor fuels.

For more information, visit **www.nacsonline.com.**

INTRODUCTION

Approximately 39 million Americans fill up their gas tanks on a daily basis, oftentimes searching for a good price and convenient location. There is arguably no product that consumers think more about on a daily basis—yet at the same time is so misunderstood.

Because U.S. convenience stores sell an estimated 80% of the gasoline purchased, NACS wants to demystify how the market works—from the time crude oil is extracted from the ground to when fuel flows into a consumer's gas tank.

As 2016 began, gas prices were at $2.00 a gallon and falling and oil prices were at lows not seen since the early 2000s. While consumers were delighted with lower prices, according to NACS surveys, prices could change as supply and demand shift, whether from world events or from the annual spring transition to summer-blend fuel.

The NACS Retail Fuels Report was developed to help facilitate an open discussion about the issues impacting supply and prices through a better understanding of the retail fuels markets and help ease frustrations that consumers often experience when gasoline prices increase. And, most importantly, we hope this resource can help provide insights and expertise on discussions that address the U.S. motor fuels industry.

More information on the fueling industry is available at **www.nacsonline.com/fuels.**

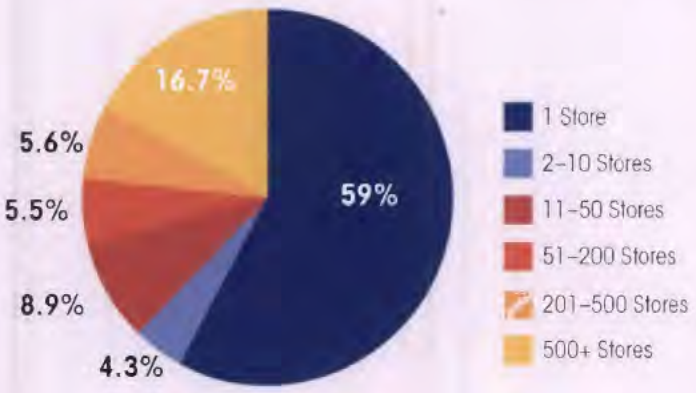
WHO SELLS AMERICA'S FUEL?

There are more than a 154,000 convenience stores in the United States, and more than 124,000 of these retail outlets sell motor fuels. In fact, U.S. convenience stores sell 80% of the gasoline purchased by Americans who fuel up their vehicles about four to five times each month.

But who owns these retail fueling locations? The answer is that it's highly unlikely the owner is an oil company, and it's very likely the store is being run by an independent operator with ties to the community.

Overall, the convenience retailing industry is dominated by single-store operators, which account for 59% of all convenience stores selling fuel (73,433 stores total). While major oil companies have essentially exited the retail fuels business, it often looks like they dominate the retail landscape. Many single-store operators may not have the resources to brand their stores separately from the companies they sell and promote on their canopies, often leading to consumer misperceptions that they are businesses owned and operated by a major oil company.

OWNERSHIP OF U.S. CONVENIENCE STORES SELLING FUEL



(Source: NACS/Nielsen 2016 Convenience Industry Store Count)

How Fuel Retailers Operate

Major oil companies have essentially exited the retail fuels business, but it often looks like they dominate the retail landscape. About half of the fueling stations in the United States sell a brand of fuel from one of the 15 major refiners/suppliers, which often makes the signage touting a particular fuel brand seem like an oil company owns the store.

The contractual relationship for fuels is much like that inside the store, where beverage companies often help provide branded fountain dispensers that dispense a branded soft drink. Both the oil company and the beverage company help the retailer sell product, but that doesn't mean they own the store.

Major oil companies shed their retail portfolios to better utilize their assets in upstream production (oil refining and/or oil production). But there is obvious value to having a company name displayed in front of millions of consumers every day, which is why the major oil companies continue to brand stations they don't own or operate. Another reason is that branded relationships provide oil companies a guaranteed customer for their product, and at predictable volumes.

Single-store operators account for 59% of all convenience stores selling fuel.

The Benefits of Being Branded

For retailers, being branded means consumer recognition. More than half of all convenience stores selling fuels (59%) are single-store operations, so having a branded contract with a major refiner/supplier instantly provides a retailer with a familiar brand for their top product: motor fuels.

While the price of gasoline is the No. 1 consideration for most consumers on where they decide to purchase gasoline, one out of 11 motorists said that the brand of fuel determines where they purchase gasoline. A branded contract guarantees fuel supply, especially when supplies are tight. Supply guarantees can smooth out extreme price volatility seen in the wholesale gas markets.

There also are non-fuel benefits to branding. Operators can take advantage of the oil company's knowledge in retail best practices for attracting customers and employee training tools. Retailers can also receive financial support such as an imaging allowance (loan) to improve the look of the store.

The Benefits of Being Unbranded

Other retails prefer to be unbranded. At unbranded stations, the fuel brand is usually the same as the store name. While this fuel doesn't have a proprietary additive package, it does have a general additive package that meets all federal and local fuels requirements. Stores typically seek to be unbranded if they feel that their store name is strong enough to convey trust in their product.

In most instances, unbranded gasoline has lower wholesale prices because there are not the added benefits of branded fuel, whether that includes marketing support, the additive package or market intelligence. Unbranded retailers are able to find the best "deal" for wholesale product on the open market, regardless of brand. They may also enter into supply arrangements with a branded company to purchase fuel that is sold as unbranded.

If supplies are tight, unbranded retailers may have more trouble obtaining product, since oil companies first service their stores, their branded contracts and other contracts. When supply is limited, unbranded retailers must compete for what's available, and wholesale prices are often much higher.

Contractual Terms for Branded Contracts

While every contract differs, here is a broad overview of what is included in these contracts:

- **Length:** A typical contract is for 10 years, although contracts may be as long as 20 years or as short as 3 years for renewed contracts.
- **Volume requirements:** Contracts typically set forth a certain amount of fuel each month that retailers must sell. Usually retailers can sell more than the agreed-to amount, but when supply disruptions exist, they may be put on allocation and only given a percentage of what they historically receive in a given time period. This enables the supplier to more efficiently manage fuel distribution to all branded outlets in an equitable fashion.
- **Image requirements:** A branded retailer receives marketing muscle from its oil company partner, which may include broad advertising to encourage in-store sales. Also, the oil company may provide financial incentives to display its brands. This also depends on who operates the station and whether the store owner has access to capital. In exchange, the oil company expects the store to adhere to certain imaging requirements, including specific colors, logos and signage, standards of cleanliness and service. The oil company often relies on mystery-shopping programs to assess compliance.
- **Wholesale price requirements:** A branded retailer must purchase fuel from a branded supplier or distributor. Branded contracts benchmark the wholesale price to common fuels indexes, such as Platt's, plus a premium of a few cents for brand/marketing support. Some branded contracts also stipulate the retail markup on the fuel through a "consignment agreement," whereby the supplier or distributor retains ownership of the fuel until it is sold and pays the retailer a commission.

Types of Branded Retailers

There are different ownership structures within the branded station universe:

- **Regional company or chain operated:** A chain of convenience stores with a common name that operates the branded locations. In many cases, a chain may sell different brands at different stores, based on the needs of the marketplace and terms of contracts that may have been carried forward from stores that were acquired from other operators. Many operations of this kind serve as distributors to themselves and maintain supply agreements with the branded oil companies.
- **Lessee dealers:** The dealer/retailer owns the business. A major or regional oil company or a distributor owns the land and building and leases it to a dealer. The dealer operates the location and pays rent to the owner, as opposed to an open dealer who owns the property. This arrangement gives the oil company or distributor a guaranteed supply outlet for its petroleum products, pursuant to a supply contract. A typical lessee dealer may operate more than one facility and does not wholesale gasoline or sell to other dealers.
- **Open dealer operated:** The independent dealer purchases fuel from the oil company or a distributor, supplies fuel to the station, and possibly others, owns the business and owns or leases the building/facility independent from any supply agreement. The dealer may contract with a manager to run the business or run it himself.
- **Company operated:** A "salary operation" where a major or regional oil company or a distributor owns the building/facility and the business. The company pays a salary to the managers/proprietors and supplies fuel to the location. This is also known as company-operated and direct operated retail.

THE PRICE PER GALLON

Retail gasoline prices are among the most recognizable price points in American commerce. And with good reason: Gasoline purchases account for approximately 4%–5% of consumer spending. The U.S. Energy Information Administration estimated that the average U.S. household spent about $2,000 for gasoline in 2015.

At the same time, gas prices are among the least understood prices in the country because they often appear to increase or decrease on a daily basis without much warning. Here is a primer on what goes into the price of a gallon of gasoline, and what causes prices to go up or down and vary from state to state and store to store.

There are four broad factors that can impact retail prices:

- **Fuel Type:** Typically, stores that sell fuel under the brand name of a refiner pay a premium for that fuel, which covers marketing support and signage, as well as the proprietary fuel's additive package. These branded stores also tend to face less wholesale price volatility when there are supply disruptions.
- **Delivery Method:** Retailers who purchase fuels via "dealer tank wagon" have the fuel delivered directly to the station by the refiner. They may pay a higher price than those who receive their fuels at "the rack" or terminal. In addition, a retailer may contract with a jobber to deliver the fuel to his stations or operate his own trucks — the choice will influence his overall cost.
- **Length of Contract:** Even if they sell unbranded fuels, retailers may have long-term contracts with a specific refiner. The length of the contract and its associated terms can affect the price that retailers pay for fuels.
- **Volume:** Retailers may receive a better deal based on the amount of fuels that they purchase, whether based on volume per store or total number of stores.

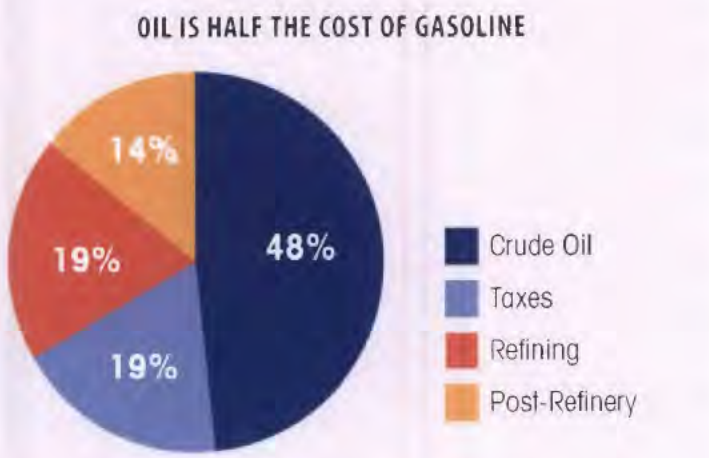
Even within a specific company, stores may not each have the same arrangements, since companies often sell multiple brands of fuels, especially if they have acquired sites with existing supply contracts.

But no matter who owns the station, retail fuels prices are ultimately affected by four sets of costs:

- **Crude oil** prices have by far the biggest effect on retail prices. Crude oil costs are responsible for about half of the cost of a gallon of gasoline. In 2015, crude oil costs were 48% of the retail price of gasoline. While there may be slight variations in the costs of refining or distributing and retailing fuels, crude oil prices can experience huge swings.
- **Taxes** are largely per gallon, although some areas have sales taxes on fuels, and those taxes increase as the price increases. There sometimes are significant disparities between stations located in the same market area but in different cities, counties or states. (See map of state tax rates on page 13.)
- **Refining costs** include the labor, materials, energy and other costs necessary for refining crude oil into gasoline, as well as the profits to refinery owners.
- **Distribution and marketing costs** are the price component that includes distributing and marketing gasoline from refiners to wholesale marketers and/or retail marketers, and the profits made by the wholesale and retail marketers.

Sales strategies can also impact gas prices. Fuel retailers face the same question that all retailers face: sell at a low profit per unit and make up for it on volume, or sell at a higher profit per unit and expect less volume? But there also are several considerations in setting fuel prices that retailers of other products don't face:

- **Wholesale Price Changes:** Competing retailers in a given area may have very different wholesale prices based on when they purchased their fuel, especially during times of extreme price volatility. Gasoline is a commodity, and its wholesale price can have wild



(Source: U.S. Energy Information Administration, cumulative 2016 monthly averages.)

swings. It's not unusual to see wholesale price swings of 10 cents or more in a given day. Depending on sales volumes and storage capacity, retailers get as many as three deliveries a day or as few as one delivery every three days or so. Due to competition for consumers, retailers may not be able to adjust their prices in response to an increase in wholesale prices because their competition may not have incurred a similar increase in their cost of goods sold. Conversely, a retailer may adjust his prices when the competition adjusts prices, either following or in advance of a shipment.

- **Contracts:** How retailers buy fuel can play a significant role in pricing strategy. Retailers sign long-term contracts (10 years is the norm), and these contracts may dictate the amount and frequency of their shipments. When supplies are tight, retailers with long-term contracts may have lower wholesale costs than retailers who compete for a limited supply on the open market, but they may also face allocations (a limit on the amount of fuel that they may obtain) on the amount of fuel they receive.

Each of these factors adds complexity to a retailer's pricing strategy, and they can create unusual market dynamics. There are times when the retailer with the highest posted price in a given area actually may be making the least per gallon, based on when, how and where the fuel was purchased.

Due to the volatility in the wholesale price of gasoline and the competitive structure of the market, fuel retailers typically see profitability decrease as prices rise, and increase when prices fall.

No matter what their pricing strategy, retailers tend to reduce their markup to remain competitive with nearby stores when their wholesale gas prices increase. This can lead to a several-day lag from the time wholesale prices rise until retail prices rise. Likewise, when wholesale gas prices decrease, retailers may be able to extend their markup and recover lost profits, with retail gas prices dropping slower than wholesale prices.

Despite extreme volatility, retail margins for fuel are fairly consistent on an annual basis. Over the past five years, the annual average retail mark-up (the difference between retail price and wholesale cost) has averaged 19.7 cents per gallon. Ultimately, retailers set a price that best balances their need to cover their costs with the need to remain competitive and attract consumers, who are very price sensitive and will shop somewhere else for a difference of a few cents per gallon.

In terms of retail profitability and its pattern, both are the opposite of what most consumers think. Due to the volatility in the wholesale price of gasoline and the competitive structure of the market, fuel retailers typically see profitability decrease as prices rise, and increase when prices fall. On average, it costs a retailer about 12 to 16 cents to sell a gallon of gasoline. Using the five-year average markup of 18.9 cents, the typical retailer averages about 5 cents per gallon in profit. (Retailer costs to sell fuel include credit card fees, utilities, rent and amortization of equipment.)

Over the course of a year, retail profits (or even losses) on fuels can vary wildly. In some cases, a few great weeks can make up for an otherwise dreadful year, or vice versa.

WHY GAS PRICES GO UP IN THE SPRING

Historically, by springtime U.S. gas prices begin to increase and generally peak around Memorial Day. Most consumers assume that prices peak at this point because of the advent of the summer-drive season. But is that the case?

To a certain extent, seasonal demand is a factor. But there are other events that, with demand, collectively have a greater effect on prices each spring, leading to price peaks right before Memorial Day. In six of the past 16 years (38% of the time), the seasonal peak took place between May 9 and May 24.

Crude oil prices drive gas prices, but how the crude oil is processed also plays a significant role in price increases. The petroleum industry's switchover to summer-blend fuels, a process that begins each February and ends June 1, creates challenges that also affect retail fuels prices. Since final implementation of the Clean Air Act Amendments in 2000, the seasonal transition to summer-blend fuel has helped gasoline prices climb significantly before they reach their peak. Comparing prices the first week in February to their seasonal peak, increases have ranged from a low of 20 cents per gallon in 2003 to a high of $1.13 per gallon in 2008; on average, the annual increase is 53 cents per gallon.

Refinery maintenance is also a factor because maintenance schedules are based on gasoline demand. Demand for gasoline in the United States is generally the lowest during the first two months of the year, so refinery maintenance, known as a "turnaround," is often scheduled during the first quarter. Another reason for scheduling turnarounds during this period is that it falls between peak heating oil

Year	Date	Price	Peak Date	Price	Increase	% increase
2015	February 2	$2.068	June 15	$2.835	76.7¢	37.1
2014	February 3	$3.292	April 28	$3.713	42.1¢	12.8
2013	February 4	$3.538	Feb. 25	$3.784	24.6¢	7.0
2012	February 6	$3.482	April 2	$3.941	45.9¢	13.2
2011	February 7	$3.132	May 9	$3.965	83.3¢	26.6
2010	February 1	$2.661	May 10	$2.905	24.4¢	9.2
2009	February 2	$1.892	June 22	$2.691	79.9¢	42.2
2008	February 4	$2.978	July 21	$4.104	$1.126	37.8
2007	February 5	$2.191	May 21	$3.218	$1.027	46.9
2006	February 6	$2.342	May 15	$2.947	60.5¢	25.8
2005	February 7	$1.909	April 11	$2.280	37.1¢	19.4
2004	February 2	$1.616	May 24	$2.064	44.8¢	27.7
2003	February 3	$1.527	March 17	$1.728	20.1¢	13.2
2002	February 4	$1.116	April 8	$1.413	29.7¢	26.6
2001	February 5	$1.443	May 14	$1.713	27.0¢	18.7
2000	February 7	$1.325	June 19	$1.681	35.6¢	26.9

(Source: U.S. Energy Information Administration)

season and peak summer drive season, allowing refineries to retool for summer-blend fuels.

After first-quarter maintenance, refineries switch to summer-blend production in April. The U.S. Environmental Protection Agency (EPA) defines April to June as the "transition season" for fuel production. Refineries lead this transition and switch over to summer-blend production in March and April.

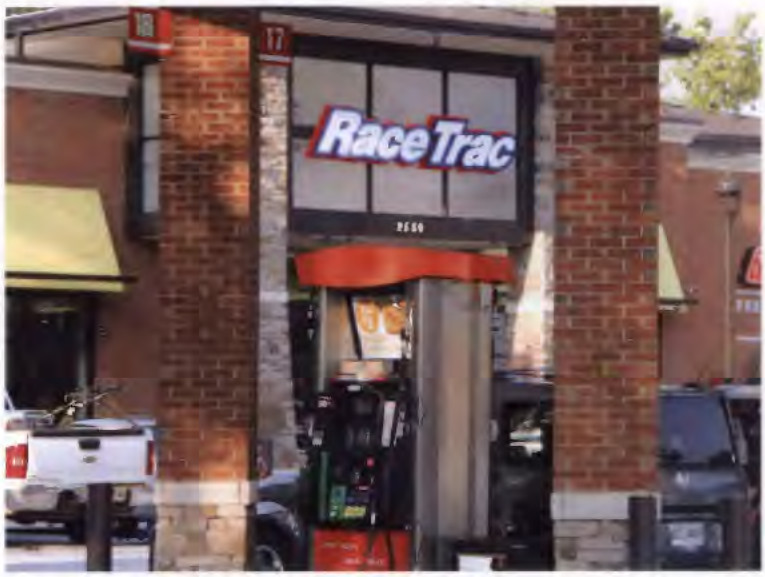
There are also more fuels to produce during the transition season. In the winter months, only a few fuels are used across the United States. However, because of various state or regional requirements, 14 different fuel specifications are required for the summer months. Refineries must produce enough for each area to ensure that there are no supply shortages.

In addition to added costs to produce the fuel, prices are also affected by increased demand, maintenance costs and capacity decreases.

The end point in a series of handoffs to prepare for summer-blend fuel is the date that retailers must sell the fuel. In most areas of the country that require summer-blend fuels, retailers have until June 1 to switch to summer-grade gas.

Some retailers must sell summer-blend fuels much earlier. In Northern California, retailers must sell summer-blend fuel on May 1, a month earlier than the rest of the country, and in Southern California, the deadline is two months earlier: April 1. One reason why California has a longer summer-blend period than other states is its longer period of high temperatures, particularly in the desert areas, which are located in the air district with the worst quality of air.

Other key deadlines put stress on the system. Nationwide, refiners must produce summer-blend fuel no later than April 1. (Obviously, deadlines are earlier for California's fuels.) From refineries, fuels travel through pipelines at about 4 miles per hour, or 100 miles per day. Fuels refined on the Gulf Coast can take several weeks to reach storage terminals throughout the country, which is why the deadline to have summer-blend fuel at terminals and storage facilities is May 1—a month after the transition at the refineries.



The May 1 deadline for terminals is considered one of the biggest factors in seasonal price increases. Terminals have to fully purge their systems of winter-blend fuels and be near empty to make the transition and be in compliance. Those terminals out of compliance face stiff penalties, so most terminal operators would rather be out of inventory than out of compliance. This regulatory requirement leads to lower inventories at the terminal. Combined with increased demand, this puts upward pressure on prices.

Demand is often cited as the main reason for spring price increases. In 2015, U.S. demand for petroleum products averaged 19.4 million barrels/day, of which 9.2 million barrels/day were gasoline. But world demand for oil is around 94 million barrels/day, more than four times the total of U.S. demand and 10 times U.S. demand for gasoline alone. U.S. demand for gasoline has declined from its peak in 2007, but world demand for oil has increased, which elevates oil prices and subsequently drives gas prices. While demand has increased, supply has increased even faster the past two years and this oversupply of product has helped push oil and gas prices downward.

2015 U.S. GASOLINE DEMAND

Month in 2015	Gasoline Demand (million barrels/day)	Change from Month Prior
January	8.718	[illegible]
February	8.650	-0.8%
March	9.055	+4.7%
April	9.139	+0.9%
May	9.251	+1.2%
June	9.391	+1.5%
July	9.438	+0.5%
August	9.467	+0.3%
September	9.275	-2.0%
October	9.250	-0.3%
November	9.109	-1.5%
December	9.305*	+2.2%

** based on preliminary numbers using weekly demand averages*

(Source: U.S. Energy Information Administration, "U.S. Product Supplied of Finished Motor Gasoline")

Still, U.S. gasoline demand is a factor in the annual spring increase. Demand begins to increase in February and typically peaks in August. The common misperception is that there is a huge increase in demand for the Memorial Day weekend with the official beginning of the summer-drive season. There is an increase in demand, but it is only a few percentage points per month.

However, a 1% increase in U.S. gasoline demand does mean that an extra 90,000 barrels per day must be produced, which is the equivalent of the output of a small refinery. During the six-month period when demand is higher, the problem is compounded. In 2015, demand per day in August was 817,000 barrels per day higher (9.4%) than in February. This demand increase creates enormous pressure on the system and makes it extremely vulnerable to supply disruptions.

As demand decreases and temperatures cool, retailers can switch over to selling winter-blend fuel, beginning September 15. While these winter-blend fuels are cheaper to produce, the complications of the switchover often lead to a temporary bump in price, usually a few cents per gallon. The weather may also affect gas prices in the fall. Hurricanes, especially those that damage Gulf Coast refining operations, place significant pressure on supplies and affect prices across the country.

Unlike in the spring, the change to winter-blend fuel is not required. However, because winter-blend fuel costs less, retailers often sell the cheaper fuel so they can be as price competitive as possible. Not all retailers begin selling this fuel on September 15; most wait to make the switch until their inventories are low. A retailer's volume will dictate how often a station receives deliveries, with some stores having multiple deliveries per day and others needing just one or two deliveries per week.

By the end of September, gas prices generally decrease as the complications from this switchover are processed and demand continues to fall. Despite what conspiracy theorists believe, price decreases in the fall have everything to do with a decrease in demand and shift in fuel specifications and nothing to do with pre-election politics.

There are exceptions to the rule. Summer-blend fuel requirements may be relaxed in times of emergencies or when potential shortages are possible. That was the case in 2005 as Hurricane

Katrina made landfall in Louisiana at the end of August and significantly affected Gulf Coast refining operations. Several states successfully petitioned for waivers to temporarily exempt retailers from reformulated gas and other fuel requirements through September 15. Only the U.S. Environmental Protection Agency (EPA) has the authority to issue these waivers.

PLASTIC AT THE PUMP

Americans have made more payments at stores by credit or debit card than they did with cash or checks every year since 2003, according to the American Bankers Association. Over the past decade, the trend has accelerated, especially at the gas pump. Today, 72% of consumers pay for fuel at the pump with plastic, according to results from the 2016 NACS Consumer Fuels Survey.

With approximately three-quarters of consumers at the pump paying by plastic, most retailers have no choice but to accept credit and debit cards. However, credit and debit card transactions result in retailers paying swipe fees (also known as interchange fees). These fees typically average between 2% and 3% of the total purchase, but can be as high as 4%. Because retailers already have razor-thin margins on fuel (the average gross margin on fuel has averaged only 6.2% before expenses over the past five years), these costs are passed along to the consumer in terms of higher gas prices.

THE COST OF PAYMENTS

(based on a 10-gallon fill-up when gas is $3.00/gallon)

Cash: none

Debit: 2.4 cents per gallon.*

Debit fees are 21 cents per transaction, plus other costs, with a maximum charge of 24 cents for the transaction. *This is only true for the 60% of debit cards that are regulated. The other 40% of debit cards carry fees that are closer to those for credit cards: around 2%.

Credit: 6 cents per gallon.

Credit card swipe fees include both fixed and variable costs. Taken together on a typical fueling, they average 2%, or 6 cents per gallon.

Gross margins aren't to be confused with profit margins. After factoring in expenses, most retailers make, at best, a few cents per gallon in pretax profit, and may even lose money on some sales when margins are tight and credit card expenses are high.

In every year since 2006, overall convenience store profits were lower than the fees that they paid credit card companies and banks for processing transactions. In 2014, the industry reported profits of $10.4 billion and credit card fees of $11.4 billion.

Skimming

Fuel dispensers can also be attractive targets for thieves looking to steal credit and debit card information by "skimming," an aggressive tactic used to illegally obtain consumer card data for fraudulent purposes. Skimming can occur at the point of sale or when a card leaves someone's sight for a brief period of time. Fuel dispensers are among the potential targets for skimming. In these cases, a third-party card-reading device is installed either outside or inside a fuel dispenser, which allows a thief to capture a customer's credit and debit card information.

Every day, 39 million Americans fuel their vehicles and 28 million (72% of all fuel customers) pay for their fuel by debit or credit card. There is no reliable data on the number of skimming incidents but they are a small fraction of overall fill-ups. Most often, only one skimmer is installed at a site that may have from 8 to 24 fuel payment points. When a skimmer is installed, it captures an average of 30 to 100 cards per day. Even if a skimmer were undetected for two weeks, it would capture data on less than 1,500 cards.

There are three types of payment points most associated with skimming:

- **Fuel dispensers:** Convenience stores sell 80% of the gas purchased in the United States, and more than 124,000 convenience stores sell fuel. The U.S. convenience store industry has 765,000 fuel dispensers (customers can fill up on each side of a dispenser) and approximately 1.45 million dispenser payment points.
- **Restaurants and bars:** An unscrupulous server can swipe a customer's card in a skimmer in addition to swiping the card legally when taking payment. There are an estimated 600,000 restaurants in the United States.
- **ATMs:** Skimming devices can be attached to ATMs to gather card information. There are about 425,000 ATMs in the United States, with an estimated 150,000 at convenience stores. ATMs located outdoors and outside of a bank are potentially more vulnerable.

To comply with EMV in the United States, convenience stores face added costs in upgrading their terminals and software to accept EMV transactions.

EMV Liability Shift

EMV is a globally accepted card specification that uses an embedded microchip to provide dynamically unique data protection when the card is inserted into a chip-card reader. EMV is an acronym for Europay, MasterCard and Visa, and is a payment specification created by EMVCo (a special entity owned by Visa, MasterCard, American Express, Discover, JCB and UnionPay). After the October 2015 liability shift, U.S. card-accepting merchants without the ability to accept EMV cards may be liable for fraudulent transactions. A similar liability shift also occurs for fuel island payment terminals after October 2017.

To comply with EMV in the United States, convenience stores face added costs in upgrading their terminals and software to accept EMV transactions. EMV payments use a computer chip located on the front of the payment card to transmit data from the card to the card reader. The chip is intended to reduce fraud and theft of consumer data.

In October 2015, Jared Scheeler, a convenience store operator in North Dakota with four Hub convenience stores, testified before the U.S. House Small Business Committee that the transition to EMV at three existing stores, including making the point-of-sale operating systems and fuel dispensers EMV compatible, has cost him approximately $44,500 per store. At a fourth store, Scheeler purchased six new fuel dispensers at $17,000 each, in addition to an EMV compatible point of sale card reader at $2,000 for in-store purchases; the total upgrade at that store has cost him more than $100,000.

Across the entire convenience and fuel retailing industry, the average cost per store to become EMV compliant is about $30,000. With more than 154,000 convenience stores across the United States, the industry will pay more than $3.9 billion to move to EMV.

Unlike the rest of the world, in the United States, new EMV cards do not require the use of a PIN (personal identification number), which weakens the effectiveness of EMV and protecting consumers from fraud. A 2013 Federal Reserve study revealed that not using PIN carries 400% more fraud, which is why PIN use is the de facto standard for world payments.

U.S. CONVENIENCE STORE INDUSTRY

The NACS/Nielsen Convenience Store Census

NACS denes a convenience store as a retail business that provides the public with a convenient location to quickly purchase a wide variety of consumable products and services, generally food and gasoline. While not a xed requirement, convenience stores have the following general characteristics:

1. Building size of fewer than 5,000 square feet.
2. Off-street parking and/or convenient pedestrian access.
3. Extended hours of operation, with many open 24 hours, seven days a week.
4. Offer at least 500 stock keeping units (SKUs).
5. Product mix includes a signicant mix of tobacco, beverages, snacks, candy and grocery items.

Since 1995, NACS has worked with Nielsen to accurately count and classify businesses in the convenience and fuel retail channel of trade. This store count is based on the convenience store universe, tracked and marketed by Nielsen, and is endorsed by NACS. View a detailed store count fact sheet at **nacsonline.com/storecount.**

Convenience stores account for **34.2%** of retail outlets in the United States tracked by Nielsen.

(Source: Nielsen as of December 31, 2015)

The U.S. convenience retailing industry has roughly doubled in size over the last three decades. At year-end 1985, the store count was 90,900 stores, at year-end 1995 the store count was 101,100 stores and at year-end 2005 the store count was 140,665 stores.

U.S. C-STORE COUNT BY REGION

As of December 31, 2015

1	32,761
2	37,645
3	23,495
4	24,498
5	13,363
6	22,433
Total	**154,195**

ARE YOU AVERAGE?

How the average American drives and uses fuel.

THE AVERAGE AMERICAN VECHICLE

Travelled 33 miles/day

(Source: U.S. Energy Information Administration; IHS Automotive)

Consumed 546 gallons of gas in 2015.

(Source: U.S. Energy Information Administration)

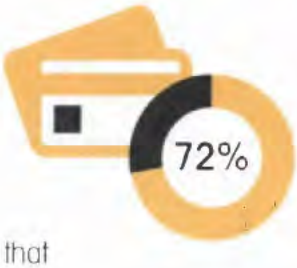
Is 11.5 years old.

(Source: IHS Automotive)

GAS CUSTOMERS

64% of gas customers say that price is the main consideration for where they fuel up.

(Source: 2016 NACS Consumer Fuels Survey)

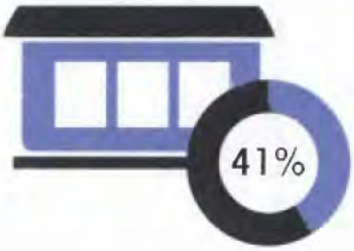


72% pay by credit card or debit card.

(Source: 2016 NACS Consumer Fuels Survey)

41% also go inside the store.

(Source: 2016 NACS Consumer Fuels Survey)



HOW DO AMERICANS GET TO WORK?

85%
drive or carpool

5%
public transportaion

3%
walk

4%
work from home

(Source: U.S. Census Bureau)

THE FUELING INDUSTRY AT A GLANCE

U.S. gasoline demand increased 2.6% to 9.2 million barrels per day in 2015.
(Source: U.S. Energy Information Administration, Short-Term Energy Outlook, January 2016)

9.2 MILLION BARRELS PER DAY

Over the past five years, **retailer gross margins have averaged 6.2%** (19.7 cents per gallon).
(Source: OPIS)

There are 257.9 million registered vehicles in the United States.
(Source: IHS Automotive)

A record 17.5 million cars and light trucks were sold in 2015.

Light-duty truck sales accounted for 56% of all vehicle sales.
(Source: Autodata Corp.)

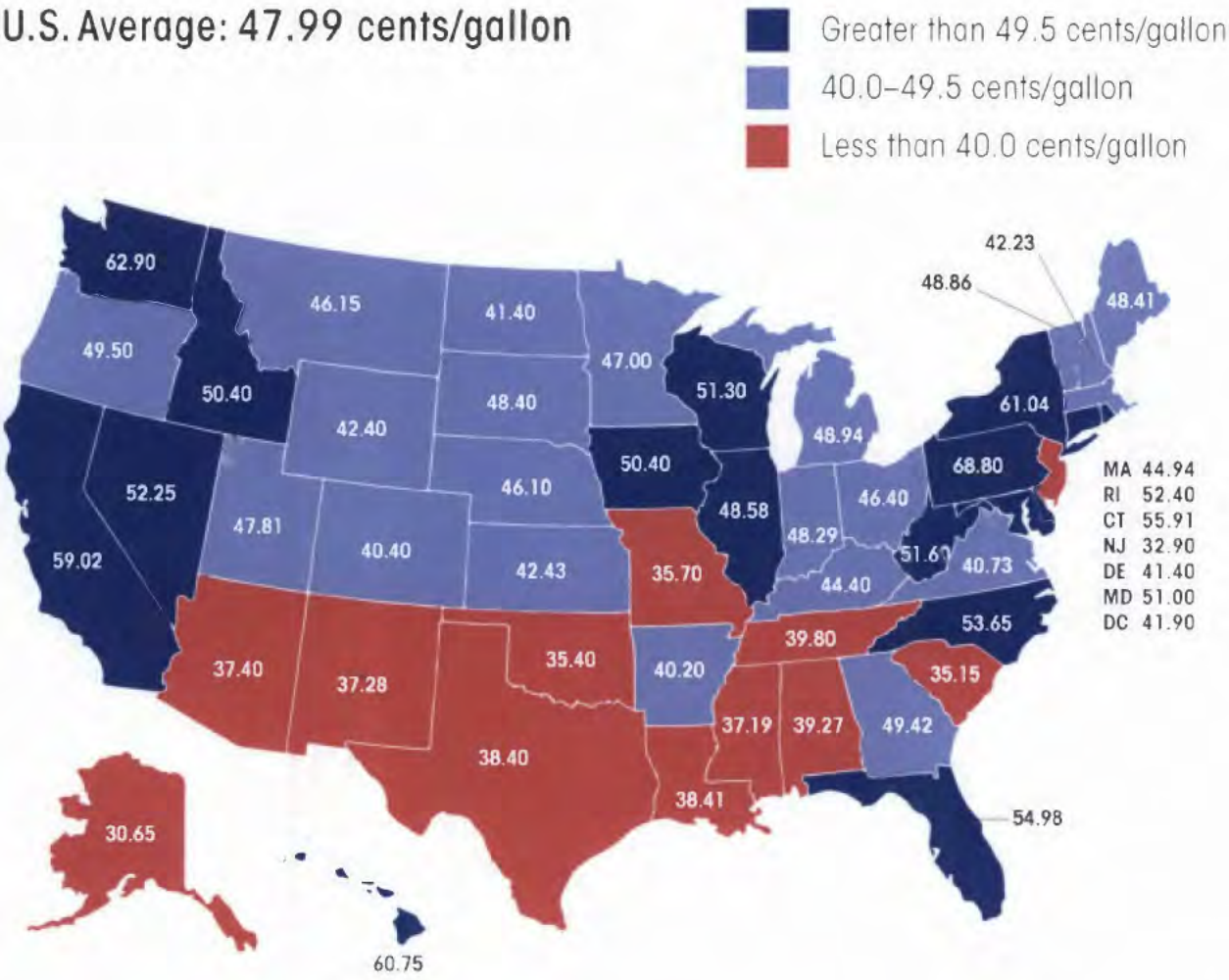
There are **124,374 convenience stores** selling motor fuels in the United States.

Less than 0.4% are owned by one of the five major oil companies.
(Source: NACS/Nielsen 2016 Convenience Industry Store Count)

GASOLINE TAXES

Combined Local, State and Federal (cents per gallon)

U.S. Average: 47.99 cents/gallon



(Source: American Petroleum Institute, as of January 14, 2016; for informational purposes only and should not be relied upon or used for compliance purposes.)

NACS®

National Association of Convenience Stores
1600 Duke Street, Alexandria, VA 22314
703/684-3600
www.nacsonline.com

Threats, Opportunities & Consolidation in Fueling

Former Gulf CEO Joe Petrowski shares his outlook at SIGMA Annual Meeting.

November 11, 2014, 10:50 pm By Brian Berk, Convenience Store News

NASHVILLE, Tenn. — In the future, the number of retail gas stations will decline significantly and the operators of such locations will change dramatically, Joe Petrowski, founder and managing partner of Mercantor Partners LLC, said Tuesday during the 2014 Annual Meeting of SIGMA: America's Leading Fuel Marketers.

The former CEO of The Cumberland Gulf Group of Cos. projects the number of U.S. gas stations will drop from the current 140,000-plus locations to 115,000 sites. He did not provide an exact timetable for when this shift will take place during his speech, entitled "Shop TOC (Threats, Opportunities and Consolidation) in Mid and Downstream Fueling."

Due to the increasing acquisition of convenience store chains by master limited partnerships flush with available cash, the c-store industry will continue to consolidate. Hence, Petrowski told the large crowd gathered at the Omni Nashville hotel that he expects the future will be highlighted by:

- 32 major U.S. c-store retailers operating 56,000 gas stations;
- 15 grocery/hypermarts with a total of 14,000 sites;
- Two mega distributors operating a combined 5,000 locations;

- 20 super distributors with 18,000 sites;
- Just 12,000 single-store operators, a large decline compared to today; and
- 10,000 unmanned locations.

Demand for fuel also will decline in coming years, stated Petrowski, due to what he referred to as "demand destruction." Corporate average fuel economy standards, the rise of alternative fuels in the marketplace and the increasing number of people over 50 years old moving to urban areas will cause this demand destruction, he said.

Natural gas, electric, biodiesel and hydrogen will all be a part of the future fuels landscape, Petrowski added. Wind and solar energy should also see growth.

"The retailer of the future will have to have multi-fueling capabilities," he asserted. "You're not going to be a one-trick pony anymore."

By Brian Berk, Convenience Store News

- *About Brian Berk Brian Berk is managing editor of Stagnito Business Information's Convenience Store News and Convenience Store News for the Single Store Owner, where he specializes in covering motor fuels, technology and financial news. He has served the magazine industry for 14 years and has also worked in the radio and newspaper fields. Berk holds a bachelor's degree in communications from the State University of New York at Cortland and a master's degree in journalism from Quinnipiac University in Hamden, Conn.*

MERCANTOR PARTNERS

SHOP TALK T.O.C.
THREATS, OPPORTUNITIES, AND CONSOLIDATION IN MID AND DOWNSTREAM FUELING

Joe Petrowski

SIGMA
AMERICA'S LEADING FUEL MARKETERS

SIGMA Nashville | November 2014

Shop Talk: Threats, Opportunities, and Consolidation

- Supply Growth
- Demand Destruction
- Fuel Diversity
- Market Structure
- Wholesale Marketing
- Capital Markets– The MLP Era
- Refining
- Terminals
- Retail Sites

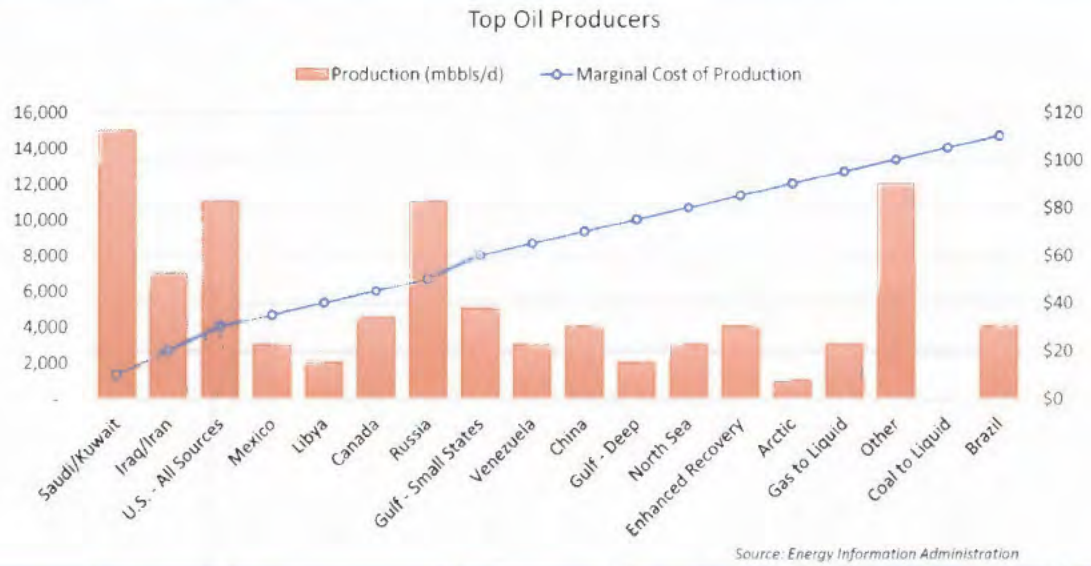
Supply Growth

- US oil production to surpass 8 million barrels/day within 3 years
- Combined with incremental natural gas from several formations, another 28 BCF of natural gas or 5 million barrels equivalent comes to market
- Privatization in Mexico and Venezuela increases supply
- Shale formations in Canada, Poland, Black Sea, and South China Sea to be taped
- Wind and solar continue growth
- Lower unit price accelerates OPEC "leak"

Supply Continued

- Cost of finding and extracting dropping faster than prices
  - New Technology
  - Element Recycling
  - Economies of scale
- Saudis and other oil rich countries increasing production
  - As prices decline, more oil is produced to balance budgets
- Privatization in Mexico and Venezuela increases production
- Brazil sitting on 15 million barrels per day production capability

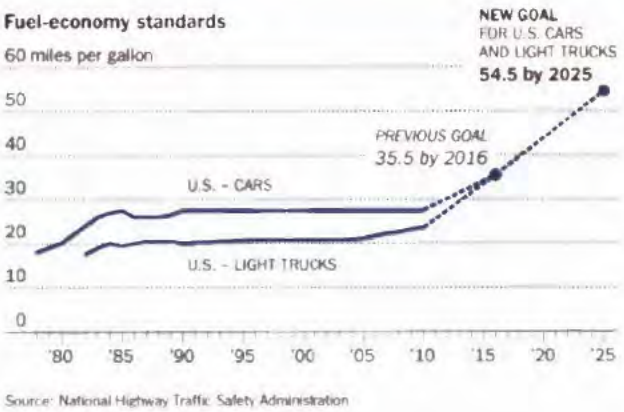
Supply Continued



Source: Energy Information Administration

Demand Destruction

- Transport fuel demand expected to decline from ~170bil gal/yr to ~160 bil gal/yr
- Potential loss of 33 billion gallons annually
  - Higher café standards (~11bil gal/yr)
  - Natural Gas (~9bil gal/yr)
  - Demographics (~5bil gal/yr)
  - Electric (~4bil gal/yr)
  - Bio (~3bil gal/yr)
  - Hydrogen (~1bil gal/yr)
- More efficient retail distribution & supply chain model



Source: National Highway Traffic Safety Administration

Consolidation will drive stronger margins.

Demand Destruction

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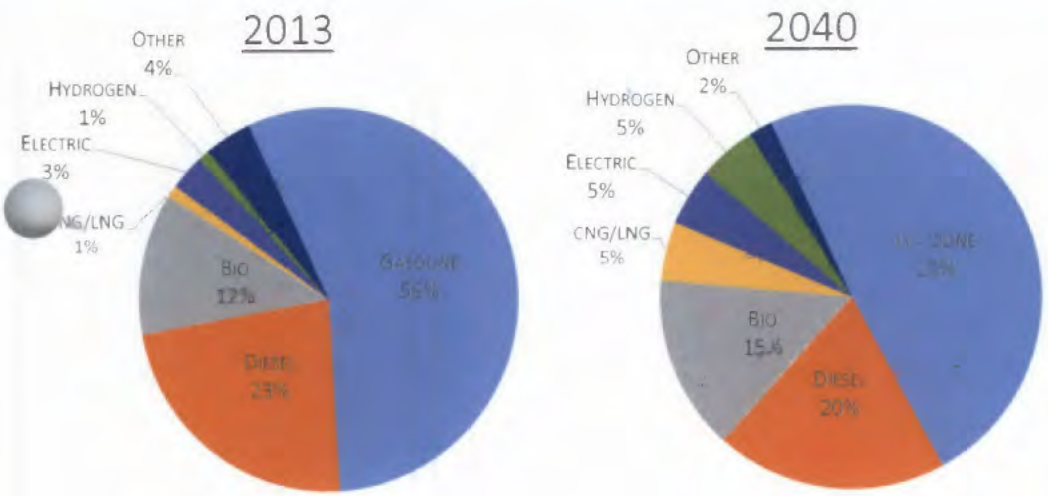
  - Bio (~3bil gal/yr)
  - Hydrogen (~1bil gal/yr)
- More efficient retail distribution & supply chain model

Age Group	Avg. Annual Miles	% of Pop. in Age Group		
		2010	2030	2050
15-19	6,244	7.02%	6.62%	6.47%
20-34	13,709	20.50%	19.07%	19.21%
35-54	15,117	27.72%	24.70%	23.93%
55-65	12,528	11.69%	10.78%	10.96%
65+	8,250	12.97%	19.30%	20.17%

Consolidation will drive stronger margins.

Fuel Diversity



Retailers must have multi-fuel flexibility.

Market Structure

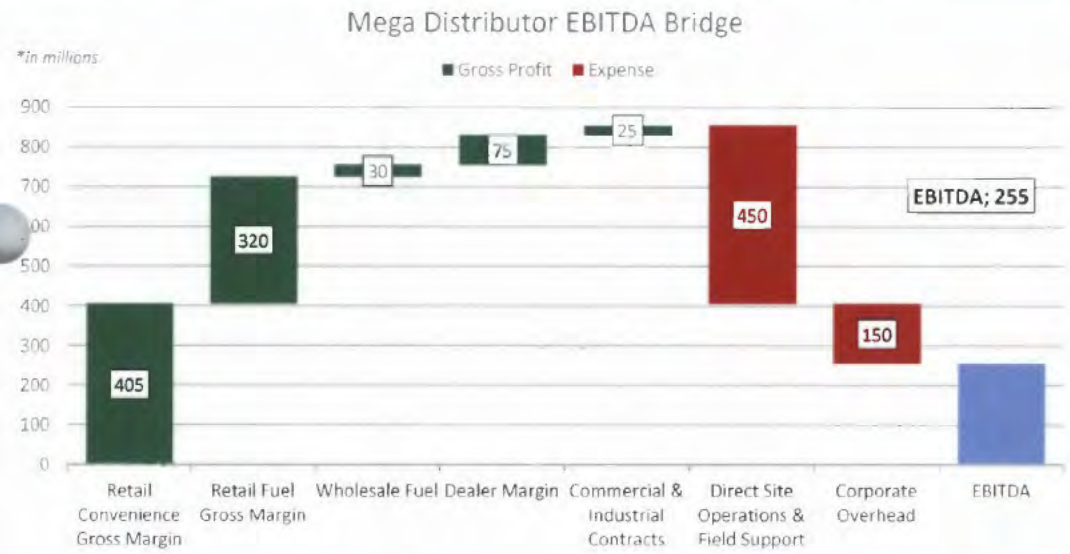
- Potential for grocery stores/wholesale clubs to increase market share from ~8% to ~30% by cross branding with manufacturers to offer rebates
  - France 52%, Australia 40%, UK 30%
- Convenience stores selling food will put pressure on retail gasoline margins to drive customer visits inside
- Niche jobbers and open dealers will be acquired by MLPs with tax advantage

Future Retail Fuel Market Share Estimates

	Number of Firms	Number of Sites	Avg. Vol. per Site	Annual Volume
Convenience Retailers	32	56,000	2 mil gal	112 bil gal
Grocery/ Hyper-marts	15	14,000	1 mil gal	14 bil gal
Mega Distributor	2	5,000	1 mil gal	5 bil gal
Super Distributor	20	18,000	1 mil gal	18 bil gal
Single Site		12,000	500,000 gal	6 bil gal
Unmanned		10,000	500,000 gal	5 bil gal
TOTAL:		115,000	1.4 mil gal	160 bil gal

Only those that are part of a large network with full food service, information technology capabilities, brand recognition, and aggregate purchasing power will prosper.

Mega Distributor



$1.7 bil 7x equity value

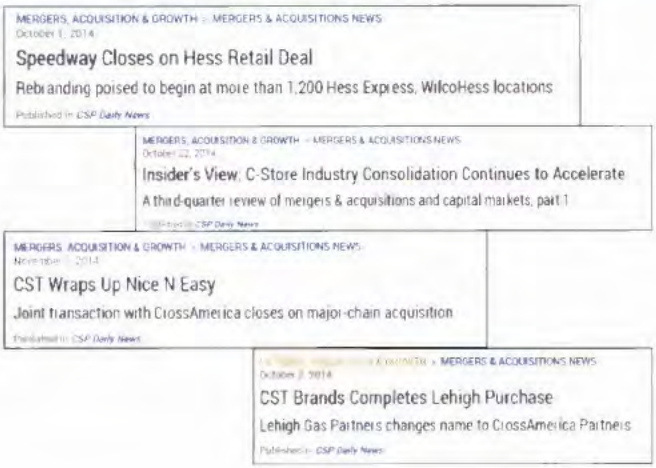
$1.0 bil Total debt

$2.7 bil Enterprise value

One company will supply up to 8.75 billion gallons or 7% of total US demand.

Wholesale Marketing

- Demand for nationwide distributor – The Amazon of Distribution, McDonalds vs. Burger King
  - Geographic Reach
  - Fuel Diversity
  - Service Capability (1 invoice)
  - Risk Management



Capital Markets – MLP Era

Capital Spending in Energy, Next 7 Years

Interstate Pipelines	$85 bil
Field Services	$20 bil
Distribution	$90 bil
GTL (Gas to Liquids)	$70 bil
CHP (Combined Heat Power)	$60 bil
New Gas Fired Generation	$80 bil
Fischer Troupe	$20 bil
Total	**$425 bil**

Source: Alerian 05/14/2014

Refining

- Decline in demand for transport fuels and EPA mandates will cause many refineries to shut down leaving only the most profitable.
- Export Refineries to stay

Terminals

- Gasoline demand expected to decline from ~135bil gal/yr to ~102 bil gal/yr
- Big Market Players with robust network expected to prosper
- Success of Terminals dependent on
  - Waterborne locations
  - Blending capability with large number of tanks
  - High optionality
  - Turning on average 18x per year

U.S. Terminal Capacity

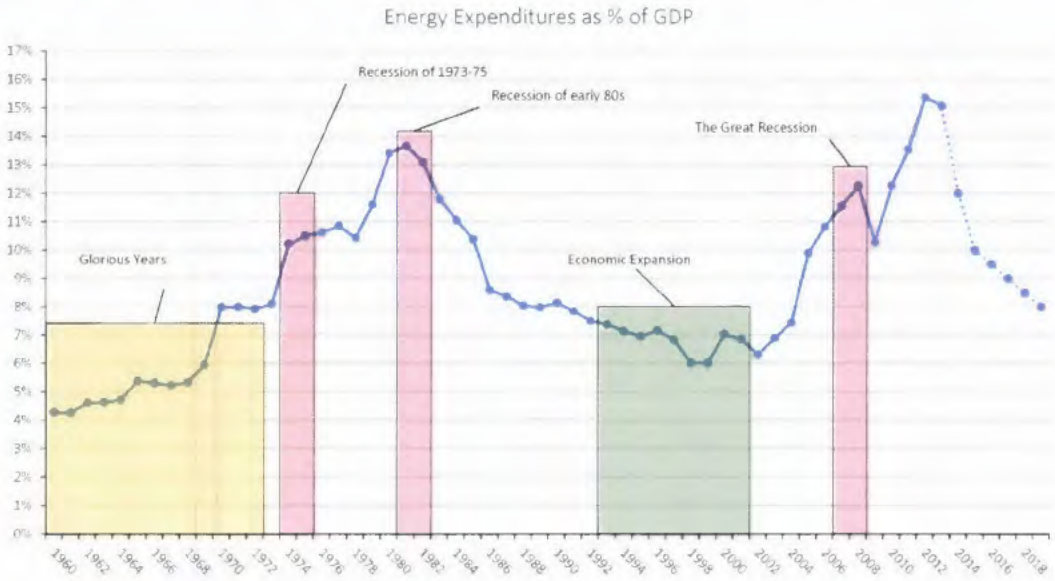
U.S. demand for terminal capacity will decline nearly 40% in 10-15 years.

Retail Sites

- Total number of sites in decline
- Significant growth in volume per site.
- Average Volume - Convenience Store with fuel (Gal/Yr)
  - 2013: 1,575,000
  - 1973: 110,400
  - Average Growth rate of 7% per year

Source: NACS Fact Book, 2013

Energy Expenditure and GDP



Economics of Hydraulic Fracturing

US fracking uses 500 million gallons of water and 200 million gallons of fracking fluids annually.

Fracking Fluids

Biocide	$20/gal
Degreaser	$160/lb
NaOH (Caustic Soda)	$380/ton
HCl (Hydrochloric Acid)	$30/liter

Cost per mmbtu

Water Cost per mmbtu	$0.80
Fluid Cost per mmbtu	$2.40
Total Cost per mmbtu	$3.20

MERCANTOR PARTNERS

Joe Petrowski

Managing Partner | Mercantor Partners
(508) 532-4911 | joe@mercantorpartners.com

EPA, Please Fix the Renewable Fuel Standard!

By Daryl Bassett, Chairman Empower Consumers, former State Regulator, Arkansas

Energy is key to nearly everything that happens here in America. Think for a second about electricity and the countless things in your house that rely on you getting the power you need at a price you can handle. A lot of thought goes into making sure that electricity is there every day for every one of us.

Now consider gasoline. Whether you live in a rural community or in the middle of a big city, you probably wouldn't be able to do one tenth of the things you do each day without it. It gets you to work, brings your family together on holidays, and delivers the goods you need at the store and the food you eat at a restaurant. Imagining our lives without gasoline is almost impossible—which is why our government needs to put a lot of thought into making sure it's both affordable and abundant.

But not everyone in the government has been getting that message. Take the Renewable Fuel Standard (RFS), a program designed with the understandable goal to increase the amount of renewable fuels that end up in everyone's gas tank. Well intended though it may be, this program has turned out to incentivize gasoline exports from refineries out of the U.S. while upsetting competition among gasoline retailers and handing an advantage to big retail chains over their small-business competitors.

Does any of that sound like it will work out well for gasoline consumers here in the U.S.? No, it doesn't—and the situation won't improve until this program is fixed. Here's why.

Under the RFS, refineries (who make gasoline) and importers (who bring it in from somewhere else) are both obligated to live up to the government's targets for how much renewable fuel gets blended into gasoline. The problem is, they usually aren't even involved in the blending! So in order to demonstrate compliance with the renewable targets, they often end up needing to buy renewable credits, pieces of paper known as RINs, that are generated at the point where renewable fuels are blended into pure gasoline. This happens downstream from refineries at what industry folks call "the rack."

If you own one of those blending points and are not a refinery or importer, you don't have to turn those RINs into the government to show compliance with its program. Instead, you're free to sell your RINs back to the refiners. So for some people, the RFS has turned out to be a welcome source of windfall profits. Who are these lucky lottery winners? In lots of cases, it's large oil companies or big gasoline retail convenience store chains with enough resources to blend their own fuel at the rack.

What's wrong with a few big gasoline retail chains enjoying extra profits generated by the RINs they sell on the market? Well, nothing—if you're one of those chains. But if you happen to be an independent gasoline retailer (many of which are minority-owned) whose competition up the street is suddenly sitting on a pile of cash, it's not so great. It means your competitor's parent company has a newfound ability to spend money on buying up stations, or making their stations

look more appealing than yours. Whatever they do, it's not helpful to a small business earning a living as an independent gasoline retailer.

Meanwhile back at the refinery, some are starting to feel squeezed. Each year, the renewables targets get higher, making those RINs more expensive. If you're not blending fuel downstream, you might start thinking about exporting the gasoline you make—which reduces the RINs you owe. And if you're an importer, do you really want to go on bringing fuel to the U.S. if costs less to ship to somewhere else? This is where things get hairy for consumers—when incentives are being created to shrink the pool of gasoline available in the U.S., which spells trouble for prices at the pump in the long run. And as some refiners get pushed over the brink, the possibility of price spikes gets even greater.

There is a way to change all this. The government could have fuel blenders abide by the RFS and turn in the RINs they generate. Eliminating that gap between refineries and fuel blenders would knock out the middle-man market for RINs, which has given rise to an alarming number of cases of fraud and speculation by opportunists attracted to the high prices those pieces of paper fetch on the market. It would restore fairness to the gasoline retail market and eliminate artificial incentives to export fuel from the U.S.

Our country has enough problems without needlessly creating new ones. Let's fix the RFS.

BUSINESS AND ECONOMIC DEVELOPMENT

Resolution BED-17-15

A RESOLUTION URGING THE U.S. ENVIRONMENTAL PROTECTION AGENCY TO ADOPT RULES ADDRESSING PROBLEMS IMPACTING MINORITY CONSUMERS AND SMALL BUSINESSES IN THE RENEWABLE IDENTIFICATION NUMBERS MARKET

WHEREAS, Congress adopted a renewable fuel standard in 2005, and expanded it in 2007, to put more biofuels in the U.S. market in order to improve the environment and energy security;

WHEREAS, the Environmental Protection Agency developed Renewable Identification Numbers (RINs) as a way to keep track of each qualifying gallon of renewable fuels;

WHEREAS, big integrated oil companies and large gasoline convenience store chain are able to earn and sell RINs;

WHEREAS, Renewable Identification Numbers can be sold and traded on a secondary market, separately from biofuels, increasing the likelihood of fraud;

WHEREAS, the current method the EPA has chosen to demonstrate compliance with that standard, has caused both excessive Wall Street speculation and fraud in the market for renewable fuels, endangering the very purpose of the program;

WHEREAS, adverse impacts on refining related to these implementation problems endanger gasoline supply and price, creating substantial unequal impacts for consumers living on fixed incomes and in communities of color;

WHEREAS, people of color own about 42 percent of independent gasoline retail stations, which are often squeezed by these implementation problems;

WHEREAS, these implementation problems also create competitive disadvantages for small gasoline retailers and convenience stores with large numbers of minority owners; and

WHEREAS, a simple administrative change to the program moving the point of obligation for providing renewable identification numbers, or RINs, downstream could fix the problem for gasoline consumers and small businesses.

BUSINESS AND ECONOMIC DEVELOPMENT

Resolution BED-17-15

THEREFORE BE IT RESOLVED, the National Black Caucus of State Legislators (NBCSL) calls on the U.S. Environmental Protection Agency to adopt a rule to address problems in the RINs market by moving the point of obligation in order to eliminate incentives for excessive speculation and fraud;

BE IT FURTHER RESOLVED, the newly created Quality Assurance Program should have a component that addresses how fraud impacts minority owners and communities of color; and

BE IT FINALLY RESOLVED, that NBCSL send a copy of this resolution to the President of the United States, the Vice President of the United States, members of Congress, and other federal and state government officials as appropriate.

SPONSOR: Representative Billy Mitchell (GA)

Committee of Jurisdiction: Business and Economic Development Policy Committee

Certified by Committee Chair: Senator Jeffery Hayden (MN)

Ratified in Plenary Session: Ratification Date is December 3, 2016

Ratification is certified by: Senator Catherine Pugh (MD), President

KeyCite Yellow Flag - Negative Treatment
Distinguished by National Federation of Federal Employees-IAM v. Vilsack, D.C.Cir., June 8, 2012

494 F.3d 161
United States Court of Appeals,
District of Columbia Circuit.

AERONAUTICAL REPAIR STATION ASSOCIATION, INC. et al., Petitioners
v.
FEDERAL AVIATION ADMINISTRATION, Respondent
Aircraft Mechanics Fraternal Association, Intervenors.

Nos. 06–1091, 06–1092.
|
Argued March 28, 2007.
|
Decided July 17, 2007.
|
Rehearing En Banc Denied Sept. 21, 2007.

Synopsis

Background: Aircraft maintenance employers filed suit, challenging final rule of Federal Aviation Administration (FAA) that mandated drug and alcohol testing, under Omnibus Transportation Employee Testing Act, for all employees of contractors and subcontractors at any tier who performed safety-related functions for air carriers.

Holdings: The Court of Appeals, Karen LeCraft Henderson, Circuit Judge, held that:

[1] mandatory testing was reasonably extended to aircraft maintenance employees of noncertificated subcontractors;

[2] FAA provided adequate notice of proposed rule;

[3] FAA adequately responded to employers' comments during rulemaking;

[4] terms of rule were not vague in violation of Due Process Clause;

[5] mandatory testing did not violate Fourth Amendment; and

[6] regulatory flexibility analysis was required.

Affirmed in part and remanded in part.

Sentelle, Circuit Judge, filed opinion, dissenting.

West Headnotes (8)

[1] **Administrative Law and Procedure**
Carriers and public utilities
Aviation
Proceedings and orders

Under *Chevron*, the Court of Appeals reviews an interpretation of statutory language by the Federal Aviation Administration (FAA), by first asking whether Congress has directly spoken to the precise question at issue, and if it has, that is the end of the matter, and the court, as well as the agency, must give effect to the unambiguously expressed intent of Congress; if, however, the statute is silent or ambiguous with respect to the specific issue, the question for the court is whether the agency's answer is based on a permissible construction of the statute.

1 Cases that cite this headnote

[2] **Aviation**
Regulation in general

Federal Aviation Administration (FAA) reasonably included in final rule noncertificated aircraft maintenance subcontractors of any tier among air carriers' contractors whose employees were "other air carrier employees" subject to mandatory drug and alcohol testing, under Omnibus Transportation Employee Testing Act, along with carriers' direct employees, since such subcontractors performed safety-sensitive function; FAA was not required to wait to extend testing to such subcontractors until an accident occurred due to substance abuse, and

testing all subcontractors as second line of defense in addition to airworthiness review by certificated contractors was reasonable. 49 U.S.C.A. § 45102(a)(1); 14 C.F.R. §§ 145.201(a)(1), 145.217(b)(2, 3).

3 Cases that cite this headnote

[3] **Aviation**

Regulation in general

Any error by Federal Aviation Administration (FAA), in notice of proposed rulemaking, characterizing as "clarification" new regulatory language extending mandatory drug and alcohol testing to all aircraft maintenance subcontractors, despite FAA's prior informal position that such testing was not required for noncertificated subcontractors, was harmless, where interested parties had opportunity to participate and comment in rulemaking, including additional opportunity to comment precisely due to FAA's conflicting guidance. 49 U.S.C.A. § 45102(a)(1); 14 C.F.R. §§ 145.201(a)(1), 145.217(b)(2, 3).

Cases that cite this headnote

[4] **Aviation**

Regulation in general

Federal Aviation Administration (FAA) adequately responded to aircraft maintenance employers' comments regarding economic impact of final rule extending mandatory drug and alcohol testing to aircraft maintenance employees of noncertificated subcontractors, since FAA specifically addressed comments about costs and benefits, found industry survey submitted by employers was not useful or credible, and rebutted expert's opinions analyzing survey results. 49 U.S.C.A. § 45102(a)(1); 14 C.F.R. §§ 145.201(a)(1), 145.217(b)(2, 3).

1 Cases that cite this headnote

[5] **Aviation**

Regulation in general

Constitutional Law

Aviation and airspace

Any uncertainty regarding meaning of "maintenance," in final rule of Federal Aviation Administration (FAA), extending mandatory drug and alcohol testing to noncertificated subcontractors' employees performing aircraft maintenance, did not violate Due Process Clause, since uncertainty existed before FAA issued final rule so was not attributable to rule, and employers could clarify term's meaning, as they always could have, by recourse to FAA's written guidance routinely provided on testing issues raised by interested parties. U.S.C.A. Const.Amend. 5; 49 U.S.C.A. § 45102(a)(1); 14 C.F.R. §§ 145.201(a)(1), 145.217(b)(2, 3).

1 Cases that cite this headnote

[6] **Constitutional Law**

Trade or Business

Courts reviewing vagueness challenges, under the Due Process Clause, allow greater leeway for regulations and statutes governing business activities than those implicating the First Amendment, in that no more than a reasonable degree of certainty in their terms can be demanded. U.S.C.A. Const.Amends. 1, 5.

Cases that cite this headnote

[7] **Searches and Seizures**

Samples and tests;identification procedures

Aircraft maintenance employees of noncertificated subcontractors were not subjected to unreasonable searches in violation of Fourth Amendment by mandatory drug and alcohol testing required under final rule of Federal Aviation Administration (FAA), given FAA's compelling interest in ensuring air safety and quintessential risk of destruction to life and property posed by substance-impaired lapses of maintenance workers at any tier. U.S.C.A.

Const.Amend. 4; 49 U.S.C.A. § 45102(a)(1); 14 C.F.R. §§ 145.201(a)(1), 145.217(b)(2, 3).

1 Cases that cite this headnote

[8] **Aviation**

Regulation in general

Aircraft maintenance contractors and subcontractors were "regulated employers," requiring Federal Aviation Administration (FAA) to conduct regulatory flexibility analysis of economic impact on employers by final rule requiring mandatory drug and alcohol testing for their employees; although rule was immediately addressed to air carriers, their aircraft maintenance contractors and subcontractors were directly affected and therefore regulated by final rule which expressly required their employees to be tested, and FAA's final economic evaluation of impact on industry was not final regulatory flexibility analysis explaining why FAA rejected alternatives to final rule. 5 U.S.C.A. § 603(a); 49 U.S.C.A. § 45102(a)(1); 14 C.F.R. §§ 145.201(a)(1), 145.217(b)(2, 3).

3 Cases that cite this headnote

*163 On Petitions for Review of a Final Rule of the Federal Aviation Administration.

Attorneys and Law Firms

Albert J. Givray and Andrew D. Herman argued the cause for the petitioners. Jere W. Glover and Marshall S. Filler were on brief.

Edward Himmelfarb, Attorney, United States Department of Justice, argued the cause for the respondent. Peter D. Keisler, Assistant Attorney General, Leonard Schaitman, Attorney, United States Department of Justice, and Paul M. Geier, Assistant General Counsel, Federal Motor Carrier Safety Administration, were on brief. Mark W. Pennak, Attorney, United States Department of Justice, entered an appearance.

Lee Seham and James R. Klimaski were on brief for amicus curiae Aircraft Mechanics Fraternal Association in support of the respondent.

Before: SENTELLE, HENDERSON and TATEL, Circuit Judges.

Opinion

Opinion for the court filed by Circuit Judge HENDERSON.

Dissenting opinion filed by Circuit Judge SENTELLE.

KAREN LeCRAFT HENDERSON, Circuit Judge:

The petitioners[1] challenge a final rule (2006 Final Rule or Rule) of the Federal Aviation Administration (FAA) which amends its drug and alcohol testing regulations, promulgated pursuant to 49 U.S.C. § 45102(a)(1), to expressly mandate that air carriers require drug and alcohol tests of all employees of its contractors—including employees of subcontractors at any tier—who perform safety-related functions such as aircraft maintenance. Antidrug and Alcohol Misuse Prevention Programs for Personnel Engaged in Specified Aviation Activities, 71 Fed.Reg. 1666 (Jan. 10, 2006). The petitioners challenge the Rule on the grounds that it impermissibly expands the scope of employees tested in violation of the unambiguous statutory language of section 45102(a)(1), the Administrative Procedure Act, 5 U.S.C. §§ 701–06, and the Fourth and Fifth Amendments to the United States Constitution. In addition, they challenge the FAA's conclusion that it was not required to conduct a regulatory flexibility analysis under the Regulatory Flexibility Act (RFA) because the Rule does not have a significant adverse effect on small entities. For the reasons set forth below, we uphold the substance of the Rule but reject the FAA's RFA determination.

1 The petitioners are: Aeronautical Repair Station Association, Inc., Premier Metal Finishing, Inc., Pacific Propeller International LLC, Texas Pneumatics Sys., Inc., Solutions Mfg., Inc. and Randall C. Highsmith, Fortner Eng'g & Mfg., Inc. and Minas Serop Jilizian intervened as petitioners.

I.

The FAA first promulgated drug testing regulations in 1988 pursuant to the Congress's general directive in 49 U.S.C. app. § 1421(a)(6) (1988) that the Secretary of Transportation "promote safety of flight of civil aircraft in air commerce" by prescribing "reasonable rules and regulations, or ***164** minimum standards." *See* Anti-Drug Program for Personnel Engaged in Specified Aviation Activities, 53 Fed.Reg. 47,024 (Nov. 21, 1988) (1988 Rule).[2] The 1988 Rule required that each employer test "each of its employees who performs" one of eight enumerated "sensitive safety– or security-related" functions, 14 C.F.R. § 21.457 (1992),[3] and defined "employee" as "a person who performs, either directly or by contract" any of the enumerated functions, 14 C.F.R. pt. 121, app. I § II (1992).

2 In its advance notice of proposed rulemaking, the FAA had invited comments on both drug and alcohol abuse and regulation, *see* 1988 Rule, 53 Fed.Reg. at 47,024, but ultimately "excluded the issue of alcohol testing from th[e] rulemaking for a variety of reasons." 1988 Rule, 53 Fed.Reg. at 47,048.

3 The eight functions listed were:
a. Flight crewmember duties.
b. Flight attendant duties.
c. Flight instruction or ground instruction duties.
d. Flight testing duties.
e. Aircraft dispatcher or ground dispatcher duties.
f. Aircraft maintenance or preventive maintenance duties.
g. Aviation security or screening duties.
h. Air traffic control duties.
53 Fed.Reg. at 47,058 (codified at 14 C.F.R. pt. 121, app. I § II).

In 1991 the Congress enacted the Omnibus Transportation Employee Testing Act (Omnibus Act), which for the first time expressly directed the FAA to promulgate alcohol and drug testing regulations:

> The Administrator shall, in the interest of aviation safety, prescribe regulations within 12 months after [October 28, 1991]. Such regulations shall establish a program which requires air carriers and foreign air carriers to conduct preemployment, reasonable suspicion, random, and post-accident testing of airmen, crewmembers, airport security screening contract personnel, and other air carrier employees responsible for safety-sensitive functions (as determined by the Administrator) for use, in violation of law or Federal regulation, of alcohol or a controlled substance. The Administrator may also prescribe regulations, as the Administrator considers appropriate in the interest of safety, for the conduct of periodic recurring testing of such employees for such use in violation of law or Federal regulation.

Pub.L. No. 102–143, tit. v, § 3, 105 Stat. 917, 953 (Oct. 28, 1991) (codified at 49 U.S.C. app. § 1434; recodified, as amended, at 49 U.S.C. § 45102(a)(1)).

Pursuant to the Omnibus Act, in 1994 the FAA revised its drug testing regulations, Antidrug Program for Personnel Engaged in Specified Aviation Activities, 59 Fed.Reg. 42,922 (Aug. 19, 1994) (1994 Drug Rule), and promulgated regulations for the first time for alcohol testing, Alcohol Misuse Prevention Program for Personnel Engaged in Specified Aviation, 59 Fed.Reg. 7380 (Feb. 15, 1994) (1994 Alcohol Rule). Both the 1994 Drug Rule and the 1994 Alcohol Rule required that an "employer" test each covered "employee," again defined as "a person who performs, either directly or by contract" any of eight listed "safety-sensitive" functions, 59 Fed.Reg. at 7390 (alcohol), at 42,928 (drugs). Both rules also listed the same eight functions, which were substantially the same as those in the 1988 Rule, *see supra* note 3:

1. Flight crewmember duties.
2. Flight attendant duties.
3. Flight instruction duties.
4. Aircraft dispatcher duties.
5. Aircraft maintenance or preventive maintenance duties.
6. Ground security coordinator duties.
7. Aviation screening duties.

*165 8. Air traffic control duties.

59 Fed.Reg. at 7391, 42,928.

On February 28, 2002, the FAA issued a notice of proposed rulemaking seeking to revise its drug and its alcohol testing regulations. Antidrug and Alcohol Misuse Prevention Programs for Personnel Engaged in Specified Aviation Activities, 67 Fed.Reg. 9366 (Feb. 28, 2002) (NPRM). Significantly, the NPRM proposed to amend the definition of a covered "employee" subject to testing as "[e]ach employee who performs a function listed in this section directly or by contract (*including by subcontract at any tier*) for an employer." 67 Fed.Reg. at 9377 (drugs) (proposed to be codified at 14 C.F.R. pt. 121, app. I § III), 9380 (alcohol) (proposed to be codified at 14 C.F.R. pt. 121, app. J § II) (emphasis added). The FAA explained that it proposed including the italicized language "to clarify that each person who performs a safety-sensitive function directly or by *any tier* of a contract for an employer is subject to testing." 67 Fed.Reg. at 9368 (emphasis added). The FAA maintained that the added language did not work "a substantive change because the current rule language states that anyone who performs a safety-sensitive function 'directly or by contract' must be tested" and "[t]he regulations have always required that any person actually performing a safety-sensitive function be tested, and we are proposing to clarify that performance 'by contract' means performance under any tier of a contract." *Id.* at 9369. The FAA further explained that it believed the clarification necessary because of "conflicting guidance provided by the FAA." *Id.*[4] The NPRM requested "comment on [its] proposal to clarify this subject." *Id.* at 9370.

4 On the "conflicting guidance," *see infra* Part IV.B.1.

In early 2004, after receiving a substantial number of critical comments, the FAA issued a final rule in which it announced that, "[i]n order to gather more information on the concerns expressed by the commenters," it was "not adopting the proposed revision in th[e] final rule" but would be "publishing a Supplemental Notice of Proposed Rulemaking (SNPRM) in the near future." Antidrug and Alcohol Misuse Prevention Programs for Personnel Engaged in Specified Aviation Activities, 69 Fed.Reg. 1840, 1841 (Jan. 12, 2004).

On May 17, 2004, the FAA published the SNPRM, addressing the subcontractor issue at length and responding to comments it had received. Antidrug and Alcohol Misuse Prevention Programs for Personnel Engaged in Specified Aviation Activities, 69 Fed.Reg. 27,980 (May 17, 2004). The SNPRM again proposed adding the "subcontract at any tier" language and reopened the subject for public comment.

The 2006 Final Rule, issued January 10, 2006, amended the testing regulations, as proposed in the NPRM and the SNPRM, to require testing employees who perform the listed functions "directly or by contract (including by subcontract at any tier)." Antidrug and Alcohol Misuse Prevention Programs for Personnel Engaged in Specified Aviation Activities, 71 Fed.Reg. 1666, 1676, 1677 (Jan. 10, 2006). In addition, the FAA certified that the 2006 Final Rule "will not have a significant economic impact on a substantial number of small entities" and that it was therefore "not required to conduct an RFA analysis." 71 Fed.Reg. at 1674.

The petitioners filed petitions for review on March 10 and March 13, 2006.

II.

The petitioners challenge the 2006 Final Rule on four grounds. We address each ground separately.

*166 *A. Statutory Authority*

[1] First, the petitioners assert that the scope of employee testing expressly required under the 2006 Final Rule—including employees of subcontractors "at any tier"—exceeds the FAA's statutory authority under the Omnibus Act. We review the FAA's interpretation of the statutory language under the familiar two-step framework of *Chevron U.S.A. Inc. v. Natural Resources Defense Council, Inc.*, 467 U.S. 837, 104 S.Ct. 2778, 81 L.Ed.2d 694 (1984). Under *Chevron*, we ask first "whether Congress has directly spoken to the precise question at issue"; if it has, "that is the end of the matter" and "the court, as well as the agency, must give effect to the unambiguously expressed intent of Congress." *Chevron*, 467 U.S. at 842–43, 104 S.Ct. 2778. If, however, "the statute is silent or ambiguous with respect to the specific issue, the question for the court

is whether the agency's answer is based on a permissible construction of the statute." *Id.* at 843, 104 S.Ct. 2778. The Omnibus Act directed the FAA to establish regulations requiring testing of "airmen, crewmembers, airport security screening contract personnel, and other air carrier employees responsible for safety-sensitive functions (as determined by the Administrator)." 105 Stat. at 953. We conclude that the statutory language is ambiguous as to whether the testing requirement applies to employees of all subcontractors, at whatever tier, and that the FAA reasonably construed the statute under the second step of *Chevron* to determine that it does.

1. "Other air carrier employees"

[2] First, the FAA reasonably concluded that the phrase "other air carrier employees" can include employees of an air carrier's contractors as well as its direct employees. Although not perhaps its most common meaning, "employee" can be used to refer to an employee of a contractor as well as to an employer's direct employee. *See Wash. Metro. Area Transit Auth. v. Johnson*, 467 U.S. 925, 933, 104 S.Ct. 2827, 81 L.Ed.2d 768 (1984) (while "word 'employee' denotes a contractual relationship and a contractor never is contractually bound to the employees of a subcontractor," general contractor and its subcontractor's employees were held to be "employer" and "employees" under section 5(a) of Longshoremen's and Harbor Workers' Compensation Act, 33 U.S.C. § 905(a), based on statute's language and history (internal quotation omitted)). Indeed, the language of the Omnibus Act indicates the Congress may have intended that "employee" have just such an expansive meaning. On its face, the Omnibus Act as initially enacted expressly required testing employees of certain contractors (in addition to direct employees), namely, "airport security screening *contract* personnel." 105 Stat. at 953 (emphasis added). Further, the phrase "and *other* air carrier employees," immediately following the list of the three specifically enumerated testing categories, suggests that the Congress considered "airport security screening contract personnel" to be employees just as it did the other two listed classes ("airmen" and "crewmembers").[5] *Id.* (emphasis added). ***167** Else the word "other," used in the sense of "more" or "additional," *see* Webster's Third New Int'l Dictionary 1598 (1993), would have been entirely inappropriate. *See also* S.Rep. No. 102–54, at 18 (May 2, 1991) ("*groups of employees* required to be covered by the new testing programs *include* airmen, crew members, and *airport security screening contract personnel* ") (emphases added). The juxtaposition of the statutory terms likewise suggests that the class of "other air carrier employees" subject to testing can be read to include other contractors' employees—a point the petitioners do not dispute. *See* Pet'rs Br. at 9 ("A person need not be on an air carrier's payroll to qualify as an 'air carrier employee.' The industry, for example, has long accepted that employees of certificated repair stations may meet this description...."). They do, however, vigorously contest that the phrase includes employees of *all* subcontractors (at whatever tier, whether or not "certificated"), contending instead that the phrase cannot reasonably embrace employees of "noncertificated" subcontractors. Before addressing their argument, we provide some background on the FAA's certificated maintenance program.

5 In 2001, the Congress enacted the Aviation and Transportation Security Act (ATSA), Pub.L. No. 107–71, 115 Stat. 597 (2001), which "creat[ed] a federal workforce to screen passengers and cargo at commercial airports." *Am. Fed'n of Gov't Employees v. Loy*, 367 F.3d 932, 934 (D.C.Cir.2004). Accordingly, it amended the alcohol and drug testing statutes by striking "contract personnel," "contract employee" and "contract employees" throughout Chapter 451 of title 49 of the U.S.Code (including section 45102(a)(1)'s reference to "airport security screening contract personnel") and replacing the terms, respectively, with "personnel," "employee" and "employees." ATSA § 139, 115 Stat. at 640. There is no indication the Congress intended the amendments to preclude continued treatment of contractors' employees as air carriers' employees subject to testing, as they were treated under the 1988 Rule and the 1994 Rule, both of which defined a covered "employee" as "a person who performs, either directly or by contract," one of the eight listed functions.

As the petitioners explain, air carriers "routinely" contract with repair stations that are "certificated" under 14 C.F.R. ch. I, subch. H, pt. 145. Pet'rs Br. at 7. A Part 145 repair station is authorized to "[p]erform maintenance, preventive maintenance, or alterations" on aviation components or to "[a]rrange for another person," that is, a subcontractor, whether certificated or not, "to perform the maintenance." 14 C.F.R. § 145.201(a)(1)(2).[6] If the subcontractor is not certificated, the certificated repair station "must ensure that the noncertificated person follows a quality control system equivalent to the system followed by the certificated repair station," *id.* § 145.202(a)

(2), and must approve the aviation component for return to service, *see id.* §§ 43.7, 145.217(b) ("A certificated repair station may contract a maintenance function pertaining to an article to a noncertificated person provided—(1) The noncertificated person follows a quality control system equivalent to the system followed by the certificated repair station; (2) The certificated repair station remains directly in charge of the work performed by the noncertificated person; and (3) The certificated repair station verifies, by test and/or inspection, that the work has been performed satisfactorily by the noncertificated ***168** person and that the article is airworthy before approving it for return to service."). With this background, we first address the FAA's interpretation of the statutory language as extending to employees of subcontractors generally, then consider the petitioners' objection to employees of noncertificated subcontractors in particular.

6 Section 145.201(a) provides:

> (a) A certificated repair station may—
>
> (1) Perform maintenance, preventive maintenance, or alterations in accordance with part 43 on any article for which it is rated and within the limitations in its operations specifications.
>
> (2) Arrange for another person to perform the maintenance, preventive maintenance, or alterations of any article for which the certificated repair station is rated. If that person is not certificated under part 145, the certificated repair station must ensure that the noncertificated person follows a quality control system equivalent to the system followed by the certificated repair station.
>
> (3) Approve for return to service any article for which it is rated after it has performed maintenance, preventive maintenance, or an alteration in accordance with part 43.
>
> 45 C.F.R. § 145.201(a)(1–3).

First, as to employees of subcontractors generally, having concluded that the statute itself expressly contemplates testing certain contractors' employees ("airport security screening contract personnel") and that the statutory phrase "other air carrier employees" may include contractors' employees, we see nothing in the statutory language that prevents the FAA from also treating a *sub* contractor's employees as statutory "employees" of air carriers. The Omnibus Act itself does not mention subcontractors and we believe the FAA, under *Chevron* step 2, reasonably included subcontractors among the contractors whose employees are "other air carrier employees" subject to testing. The FAA soundly reasoned that "it is important that individuals who perform any safety-sensitive function be subject to drug and alcohol testing under the FAA regulations" and that to conclude otherwise "would be inconsistent with aviation safety." 2006 Final Rule, 71 Fed.Reg. at 1667.

As for employees of "noncertificated" subcontractors in particular, we believe that they too may be reasonably treated as "other air carrier employees" and thus subject to mandatory testing under the Omnibus Act. The petitioners do not object to the FAA's requiring drug and alcohol testing of certificated subcontractors' employees, noting that the aviation industry "has long accepted that employees of certificated repair stations may meet this description because they work in the aviation industry, deal directly and routinely with air carriers, are heavily regulated by the FAA, and (like an air carrier's own specially licensed employees) are involved in the critical function of making airworthiness determinations," Pet'rs Br. at 9. They insist, however, that employees of "noncertificated" subcontractors may not be considered air carrier "employees" subject to mandatory testing and they offer what may well be a valid ground for treating certificated and non-certificated subcontractors differently, namely, that "[f]or certificated entities, ... drug and alcohol testing logically operates as part and parcel of an already-comprehensive program of government supervision" so that "the certificated firm—precisely because it chooses to be certificated—can be seen as acting as an alter ego of the air carrier, so that its workers can be fairly characterized as 'air carrier employees.' " *Id.* at 15. This distinction, however, is not mandated by the language of section 45102(a)(1) which says nothing about certification *vel non*. What section 45102(a)(1) does require is that the FAA Administrator determine those "safety-sensitive functions"—performed by other than "airmen, crewmembers, [and] airport security screening contract personnel"—subject to drug and alcohol testing and the FAA has consistently and reasonably included aircraft maintenance work among such functions. *See* 1994 Alcohol Rule, 59 Fed.Reg. at 7391 (including aircraft maintenance or preventive maintenance duties among "safety-sensitive" duties); 1994 Drug Rule, 59 Fed.Reg. at 42,928 (same); *cf.* 1998 Rule, 53 Fed.Reg. at 47,058 (including "maintenance or preventive maintenance" among "sensitive safety- or security-related" duties subject to drug testing). It is

not unreasonable, then, to construe the statute, as the FAA does, to require testing of maintenance employees, certificated or not, in order to ensure that all maintenance work, by whomever performed, is done properly and that each aviation component *169 is safe for aviation use. In the FAA's view, it "would be inconsistent with aviation safety for individuals performing maintenance work within the certificated repair station to be subject to drug and alcohol testing, while individuals performing the same maintenance work under a subcontract would not be subject to drug and alcohol testing." 71 Fed.Reg. at 1670. The petitioners nonetheless cite four "principles of statutory interpretation," Pet'rs Br. at 11, which, they contend, undermine the FAA's interpretation. We find none of them compelling.

The petitioners first assert the FAA's interpretation "would offend the basic principle that statutes 'must be harmonized' " because it "runs headlong into a robust congressional policy of promoting the nation's small businesses." Pet'rs Br. at 11 (quoting 82 CJS Statutes § 352; citing 15 U.S.C. § 631(a) ("It is the declared policy of the Congress that the Government should aid, counsel, assist, and protect, insofar as is possible, the interests of small-business concerns...."). We note no disharmony in the FAA's regulation. The Congress has provided a specific statutory procedure under the RFA to ensure that "agencies shall endeavor, consistent with the objectives of the rule and of applicable statutes, to fit regulatory and informational requirements to the scale of the businesses, organizations, and governmental jurisdictions subject to regulation." RFA, Pub.L. No. 96-354, § 2(b), 94 Stat. 1164, 1165 (1980). This is the procedure which the Congress mandated to harmonize the express interest advanced in the Omnibus Act's testing provisions—"the interest of aviation safety," 49 U.S.C. § 45102(a)(1)—with the concerns of small businesses. If the FAA properly follows the procedure in its rulemaking —a matter we address *infra* Part II.D—it discharges its responsibility in this regard.

The petitioners next assert the FAA's interpretation will impermissibly " 'imping[e] upon important state interests,' " Pet'rs Br. at 11 (quoting *BFP v. Resolution Trust Corp.*, 511 U.S. 531, 544, 114 S.Ct. 1757, 128 L.Ed.2d 556 (1994)), because "extension of the federal government's drug-and-alcohol testing regime to noncertificated subcontractors necessarily will disrupt state choices about both (i) the privacy interests of local employees and (ii) the business prerogatives of local employers," *id.* (state statutory citations omitted). This argument fails, however, because the Omnibus Act expressly preempts state drug testing laws. *See* 49 U.S.C. § 45106(a) ("A State or local government may not prescribe, issue, or continue in effect a law, regulation, standard, or order that is inconsistent with regulations prescribed under this chapter.").

Third, the petitioners contend that the FAA's interpretation "would violate the rule that: 'A statute must be construed, if fairly possible, so as to avoid not only the conclusion that it is unconstitutional but also grave doubts upon that score.' " relying on its contention that the 2006 Final Rule violates the Fourth Amendment. Pet'rs Br. at 12 (quoting *Almendarez-Torres v. United States*, 523 U.S. 224, 237, 118 S.Ct. 1219, 140 L.Ed.2d 350 (1998)). As our discussion below reveals, however, the petitioners' Fourth Amendment challenge offers no "grave concerns" about the 2006 Final Rule's constitutionality. *See infra* Part II.C.

Finally, the petitioners assert the FAA's interpretation ignores the "context" of the legislation—namely, the "major legal and political concerns" that widespread drug testing of employees might raise, Pet'rs Br. at 13—and the Congress's own admonition that "the Administrator be very selective in extending the coverage of this provision to other categories of air carrier *170 and FAA employees" and that "[the statute] should not be treated as an open authorization to test all aviation industry employees." S.Rep. No. 102-54, at 18 (May 2, 1991). In the quoted report, however, the Congress singled out "mechanics" as among the employees required to be tested "[a]s defined in statute and regulation." *Id.* at 17. And nowhere does the legislative history distinguish between mechanics employed by certificated subcontractors and those employed by noncertificated subcontractors.

2. "Employees Responsible for Safety-Sensitive Functions"

Second, the petitioners assert that the FAA exceeded its statutory authority because noncertificated subcontractors' employees are not "employees responsible for safety-sensitive functions" as required under section 45102(a)(1). They argue that under FAA regulations, if "a certificated repair station has used a noncertificated subcontractor, only the certificated repair station is 'responsible' for the safety aspects of the subcontractor's work." Pet'rs Br. at 18 (citing 14 C.F.R. § 145.217(b)(2), (3) (requiring certificated repair station to verify

satisfactory performance of subcontracted noncertificated work and airworthiness of aviation component before return to service)). The FAA responds that "responsible for" as used in section 45102(a)(1) does not mean "legally responsible for," as the petitioners argue, but simply the "agent" or "cause," in this case denoting the person performing the maintenance work. FAA Br. at 26–27. The FAA's interpretation of the phrase "responsible for" is a permissible one. *See* Webster's Third New Int'l Dictionary 1935 (1993) (defining "responsible" as "answerable as the primary cause, motive, or agent"); *Hines v. Blue Cross Blue Shield of Va.*, 788 F.2d 1016, 1018 (4th Cir.1986) ("The ordinary meaning of a 'person responsible for such injuries' is the person who caused the injuries, who did the damage."). Because the Congress expressly directed the FAA Administrator to determine by regulation those "other air carrier employees responsible for safety-sensitive functions," we defer to the FAA's interpretation. *See Envtl. Def. v. EPA*, 489 F.3d 1320, 1328–29 (D.C.Cir.2007) (if Congress " 'has explicitly left a gap for the agency to fill,' " we uphold agency's "reasonable statutory interpretation") (quoting *Chevron*, 467 U.S. at 843–44, 104 S.Ct. 2778).

B. Administrative Procedure Act

Next, the petitioners contend that requiring testing of maintenance employees of all subcontractors violates the APA in three respects. We disagree on all counts.

1. Notice

[3] The petitioners contend the FAA's "mischaracterization" of the new regulatory language as a "clarification" "tainted all aspects of the rulemaking process with error," Pet'rs Br. at 29, and, in particular, "rendered the agency's notice of proposed rulemaking misleading and thus procedurally improper," *id.* at 32. There is some substance to the petitioners' claim that the inclusion in the 2006 Final Rule of the "subcontract at any tier" language is more than simply a "clarification," as the FAA repeatedly dubbed it. *See, e.g.*, 2006 Final Rule, 71 Fed.Reg. at 1666, 1667, 1668, 1669, 1670. The FAA concedes that its own informal guidance, to which it adhered until the mid–1990s, took the position that employees of noncertificated subcontractors did not have to be tested. *See* NPRM, 67 Fed.Reg. at 9369–70; 2006 Final Rule, 71 Fed.Reg. at 1670.[7] And it *171 appears that any subsequent guidance to the contrary may not have been effectively disseminated. *See, e.g.*, SNPRM, 67 Fed.Reg. at 27,985 ("Although we believe that we are merely clarifying the regulations, we recognize that, due to the previous conflicting guidance, some companies with existing programs and some non-certificated contractors may have to modify their current alcohol misuse prevention and antidrug programs."). Thus, the additional language may more accurately be viewed as a choice between two conflicting positions than as a clarification. Nonetheless, the alleged "mischaracterization" does not warrant overturning the 2006 Final Rule. The FAA went out of its way to ensure that interested parties had the opportunity to participate and comment in the rulemaking—to the point of issuing the SNPRM seeking additional comment, and thereby delaying issuance of a final rule, precisely because of the conflicting guidance and possible consequent confusion. *See* SNPRM, 69 Fed.Reg. at 27,980–81. As a result, the entire air carrier industry, of which the petitioners are part, was well aware of the rulemaking and its substance and cannot reasonably claim ignorance of the proceeding or inadequate opportunity to comment. "If anything, [the FAA proceedings] provided Industry with a far greater opportunity to participate in the rulemaking than a plain vanilla notice-and-comment proceeding." *Natural Res. Def. Council, Inc. v. EPA*, 822 F.2d 104, 121 (D.C.Cir.1987). Thus, "the parties had abundant opportunity to comment on the proposed rule" and "any error was harmless." *Id.*[8]

7 The 2006 Final Rule states: "As we acknowledged in the NPRM and SNPRM preambles, some of our early guidance only required subcontractors who took airworthiness responsibility to be subject to drug and alcohol testing. By the mid 1990s, the guidance we developed eliminated the airworthiness responsibility component and followed the rule language explicitly." 71 Fed.Reg. at 1670.

8 The petitioners also contend the alleged mischaracterization resulted in "substantive analytical error," Pet'rs Br. at 32, asserting it affected the FAA's estimate of the Rule's costs to the industry. This issue can be resolved on remand when the FAA reexamines the economic impact of the Rule on small business entities under the RFA. *See infra* Part II.D.

2. Arbitrary and Capricious Standard

The petitioners assert the 2006 Final Rule violates the APA's proscription against arbitrary and capricious rulemaking in two respects. First, they claim the 2006 Final Rule is arbitrary because it is inconsistent with the FAA's "overarching regulatory scheme" for maintenance and certification. Pet'rs Br. at 25. The petitioners maintain that because only certificated persons can perform maintenance under 14 C.F.R. § 43.3, employees of noncertificated subcontractors cannot perform "maintenance" but only "maintenance functions." But the FAA's regulations permit a certificated repair station to contract out maintenance work it would otherwise have performed provided the certificated entity performs an airworthiness "sign-off" on the work before the component is returned to service. *See* 14 C.F.R. § 145.217. The task performed by subcontractors is no less safety-sensitive for being contracted out to another entity.

Second, the petitioners contend the FAA did not adequately explain the need to test all subcontractors' employees. We disagree. As noted above, the FAA reasonably determined it "would be inconsistent with aviation safety" to treat employees of certificated and noncertificated contractors differently given that they all perform the safety-sensitive function of maintenance. 71 Fed.Reg. at 1670. Ensuring that front-line maintenance workers do not make errors on account of drug or alcohol use ***172** makes it less likely that such errors will compromise air safety.

The petitioners reply with four reasons they claim testing is not necessary. They first contend there is "no evidence that any accident has resulted from drug or alcohol use by any worker employed by any noncertificated subcontractor." Pet'rs Br. at 34–35. Nonetheless, they acknowledge that "testing has revealed drug and alcohol use in the past, and expanded testing will sometimes turn up such use among workers at the noncertificated subcontractor level." Pet'rs Br. at 34. Thus, it may be only a matter of time before an accident attributable to substance abuse occurs. We do not believe the FAA must—or should—wait until then. *Cf. Nat'l Fed'n of Fed. Employees v. Cheney*, 884 F.2d 603, 610 (D.C.Cir.1989) ("It is readily apparent that the Army has a compelling safety interest in ensuring that the approximately 2,800 civilians who fly and service its airplanes and helicopters are not impaired by drugs. Employees in each of the covered positions—air traffic controllers, pilots, aviation mechanics and aircraft attendants—perform tasks that are fraught with extraordinary peril: A single lapse by any covered employee could have irreversible and calamitous consequences.").

The petitioners' second reason relates to their contention that the subcontractor testing requirement is redundant given the airworthiness review required to be performed by a certificated repair station that subcontracts a maintenance task. We do not believe, however, it is arbitrary to impose a second line of defense, involving the very employees performing the repairs, to further promote air carrier safety. *See* 2006 Final Rule, 71 Fed.Reg. at 1669 ("While there might be redundancies built into the maintenance system, the supervisory and other quality assurance processes involved in aviation maintenance do not constitute a substitute for the protections afforded by drug and alcohol testing. Therefore, we will continue to require subcontractors be subject to drug and alcohol testing."). [9]

9 Further, the claimed redundancy has always been present for noncertificated employees of a certificated contractor (or of an air carrier itself) who are subject to testing notwithstanding their work is checked by certificated employees. *See* 2006 Final Rule, 71 Fed.Reg. at 1669–70 ("Within certificated repair stations, there are non-certificated individuals such as mechanic's helpers, who have been subject to testing for more than 15 years.")

The petitioners next reason that the FAA should have considered alternative "less restrictive forms of regulation." Pet'rs Br. at 36. The Supreme Court, however, has "made clear that the reasonableness of a particular technique does not 'necessarily or invariably turn' on the existence of less intrusive alternatives," *Nat'l Fed'n of Fed. Employees*, 884 F.2d at 610 (quoting *Skinner v. Ry. Labor Executives' Ass'n*, 489 U.S. 602, 629 n. 9, 109 S.Ct. 1402, 103 L.Ed.2d 639 (1989)).

Finally, the petitioners contend the 2006 Final Rule will have a "net *negative* safety impact," Pet'rs Br. at 37 (emphasis in original), because it will divert inspection resources from employees of certificated contractors and subcontractors and drive away both qualified, experienced noncertificated subcontractors and their skilled employees. The petitioners, however, offer no evidentiary support for this claim (nor did so before the FAA) and we therefore reject it.

3. Comments

[4] The petitioners also contend the FAA failed to respond adequately to comments on the 2006 Final Rule's impact on ***173** industry business costs and employees' privacy costs. We conclude the FAA's response was adequate.

With regard to the industry costs, the petitioners rely in particular on an industry survey they submitted to the FAA, along with an analysis of it by "a distinguished aviation industry economist," Pet'rs Br. at 39, which they claim contradicts the FAA's assessment that "none of the commenters opposing the proposal provided specific data challenging the FAA's fundamental economic assumptions," 2006 Final Rule, 71 Fed.Reg. at 1667. Yet immediately following the quoted statement, the 2006 Final Rule went on to note that "[t]he regulatory evaluation accompanying this final rule specifically addresses the comments about costs and benefits." *Id.* In the cited evaluation, the FAA responded at length to the information the commenters submitted, finding, inter alia, that "most of the survey information" was not "useful or credible," JA 112, and rebutting the expert's opinions, JA 113–15.

With regard to employees' privacy interests, the petitioners assert the FAA ignored comments complaining that subjecting employees of all subcontractors to the testing requirements will "trigger[ ] countless invasions of privacy through the administration of preemployment, reasonable-suspicion, incident-based, and ongoing random testing, including for employees with flawless past work records and no hint of prior substance abuse." Pet'rs Br. at 41. Again, the FAA responded, albeit succinctly: "[T]he issues regarding invasion of privacy were resolved more than 15 years ago when the drug testing regulation carefully balanced the interests of individual privacy with the Federal government's duty to ensure aviation safety. The purpose of this rulemaking is not to reopen the long-settled issue of invasion of privacy." 71 Fed.Reg. at 1668. The petitioners respond that the 2006 Final Rule "presents much-heightened privacy concerns," Pet'rs Br. at 22, but do not explain precisely what the heightened concerns are or point to comments that do so. To the extent the purported expansion of the testing class affects privacy rights, we address this issue in our Fourth Amendment discussion. *See infra* Part II.C.

C. Constitutional Challenges

The petitioners raise two constitutional challenges to the 2006 Final Rule, alleging the FAA violated the Due Process Clause of the Fifth Amendment and the Fourth Amendment's guarantee against unreasonable search and seizure. We reject each challenge in turn.

[5] [6] The petitioners first claim the 2006 Final Rule, insofar as it extends the testing to employees of noncertificated subcontractors, is so vague as to violate due process because it is unclear what constitutes "maintenance" for which testing is required —and, in particular, where the FAA draws the line between "maintenance" and "preventive maintenance," for which testing is not required. *See* 14 C.F.R. § 1.1 (defining "maintenance" as "inspection, overhaul, repair, preservation, and the replacement of parts, but exclud[ing] preventive maintenance"). Whatever uncertainty exists regarding the meaning of "maintenance," however, existed before—and, according to the petitioners, was enhanced by guidance disseminated after—the 2006 Final Rule issued and is therefore not attributable to it. In any event, the court "allow[s] greater leeway for regulations and statutes governing business activities than those implicating the first amendment"—"no more than a reasonable degree of certainty can be demanded." *Throckmorton v. NTSB*, 963 F.2d 441, 445 (D.C.Cir.1992) (internal quotations ***174** & citations omitted). In this case, employers can clarify the term's meaning as they always have-by recourse to the written guidance which the FAA routinely provides on testing issues raised by interested parties. *See, e.g.*, JA 175, 180; Pet'rs Br. at 27–28 (noting guidance on meaning of "maintenance" issued since 2006 Final Rule). Thus, "the regulated enterprise" has "the ability to clarify the meaning of the regulation by its own inquiry, or by resort to the administrative process." *Vill. of Hoffman Estates v. Flipside, Hoffman Estates, Inc.*, 455 U.S. 489, 498, 102 S.Ct. 1186, 71 L.Ed.2d 362 (1982).

[7] The petitioners next contend the 2006 Final Rule's drug testing requirement subjects employees of noncertificated subcontractors to unreasonable searches in violation of the Fourth Amendment. Again we disagree.

In *National Federation of Federal Employees v. Cheney*, 884 F.2d 603 (D.C.Cir.1989), the court upheld against a Fourth Amendment challenge the U.S. Army's practice of subjecting civilian aviation maintenance personnel to compulsory, random toxicological urine testing because the Army had a compelling interest in ensuring air safety given "the quintessential risk of destruction to life and property posed by aviation." 884 F.2d at 610. The same justification exists here. Nonetheless, the petitioners offer three grounds for finding the testing program unconstitutional.

First, the petitioners assert that the employees subject to testing are "ordinary citizens." The same is true, however, of the employees of certificated air carrier contractors and subcontractors and was true of the civilian employees in *National Federation*. Yet the petitioners do not suggest these groups may not constitutionally be tested.

Second, the petitioners object to the expansive scope of the testing insofar as it applies to all maintenance work, all employees who "participate" in the work and, especially, to current employees of noncertificated subcontractors. These objections applied as well to employees of a certificated contractor or subcontractor when they first became subject to testing in the late 1980s. Further, as to the first objection specifically, as indicated previously, the FAA can work out through guidance and consultation with subcontractors (as it has with certificated contractors and subcontractors) what is and is not test-triggering "maintenance" work. Further, as to the third objection, while testing of incumbents may as a general matter require a closer relationship between the employee's job and the government interest served than does testing of new applicants, *see Stigile v. Clinton*, 110 F.3d 801, 805–06 (D.C.Cir.1997); *Willner v. Thornburgh*, 928 F.2d 1185, 1188 (D.C.Cir.1991), the nexus between aircraft mechanical work and aviation safety is sufficient, as our decision in *National Federation* made clear.

Third, the petitioners argue, as earlier, that the additional testing "simply 'is not needed' " in light of the airworthiness testing all aviation components undergo before being placed in service. Pet'rs Br. at 46 (quoting *Chandler v. Miller*, 520 U.S. 305, 320, 117 S.Ct. 1295, 137 L.Ed.2d 513 (1997)). We reject this argument here for the same reasons given earlier. *See supra* Part II.B.2. Because of "the quintessential risk of destruction to life and property" posed by substance impaired lapses by maintenance workers at any tier, the testing is justified under *National Federation*.

D. Regulatory Flexibility Act

Last, we address the petitioners' RFA challenge. Under the RFA an agency required to file a notice of proposed rulemaking ***175** "shall prepare and make available for public comment an initial regulatory flexibility analysis," which "shall describe the impact of the proposed rule on small entities." 5 U.S.C. § 603(a). Along with the final rule, "the agency shall prepare a final regulatory flexibility analysis" which "shall contain," inter alia,

> **(2)** a summary of the significant issues raised by the public comments in response to the initial regulatory flexibility analysis, a summary of the assessment of the agency of such issues, and a statement of any changes made in the proposed rule as a result of such comments; [and]
>
> ...
>
> **(5)** a description of the steps the agency has taken to minimize the significant economic impact on small entities consistent with the stated objectives of applicable statutes, including a statement of the factual, policy, and legal reasons for selecting the alternative adopted in the final rule and why each one of the other significant alternatives to the rule considered by the agency which affect the impact on small entities was rejected.

Id. § 604(a). These requirements, however, "shall not apply to any proposed or final rule if the head of the agency certifies that the rule will not, if promulgated, have a significant economic impact on a substantial number of small entities." *Id.* § 605(b).

In the NPRM, the FAA performed a tentative RFA analysis and counted among RFA small entities both air carriers and Part 145 repair stations but, because it was "unable to determine how many of the 2,412 part 145 repair stations are considered small entities," it "call[ed] for comments and request [ed] that all comments be accompanied by clear documentation." 67 Fed.Reg. at 9376.

In the SNPRM, the FAA determined that "the small entity group is considered to be part 145 repair stations," 69 Fed.Reg. at 27,986, but still "unable to determine how many of the part 145 repair stations and their subcontractors are considered small entities," concluded that "[m]ost, if not all [non-certificated maintenance contractors] would be considered small entities," *id.* Based on its calculation of annualized costs of less than 1% of annual median revenue, the FAA stated it "believe[d] that this proposed action would not have a significant economic impact on a substantial number of small entities" but "solicit[ed] comments on this determination, on these assumptions, on the annualized cost per company, and on their annual revenue." *Id.*

[8] After receiving comments, the FAA took a different tack in the 2006 Final Rule and "disagree[d]" with "commenters who raised RFA issues," asserting that contractors are not among entities regulated under the testing regulations for the purpose of the RFA. 71 Fed.Reg. at 1673. The FAA noted that "the directly regulated employers are: Air carriers operating under 14 CFR parts 121 and 135; § 135.1(c) operators; and air traffic control facilities not operated by the FAA or by or under contract to the U.S. military," who "must conduct drug and alcohol testing under the FAA regulations." *Id.* "For drug and alcohol testing purposes, certificated repair stations are contractors, and contractors are not regulated employers." *Id.* (citing 14 CFR pt. 121, app. I, § II (defining "employer"); *id.* app. J, § I(D) (same)). Accordingly, the FAA concluded it was "not required to conduct an RFA analysis, including considering significant alternatives, because contractors (including subcontractors at any tier) are not the 'targets' of the proposed regulation, and are instead indirectly regulated entities." ***176** *Id.* at 1674. The petitioners contend the FAA's determination is incorrect. We agree with the petitioners that the contractors and subcontractors are regulated employers and that the RFA therefore requires that the FAA consider the economic impact of the 2006 Final Rule on them. In reviewing this conclusion, we do not defer to the FAA's interpretation of the RFA—and specifically whether contractors and subcontractors are "regulated" entities directly affected by the regulations—because the FAA does not administer the RFA. *See Am. Trucking Ass'ns v. EPA*, 175 F.3d 1027, 1044 (D.C.Cir.1997) (no deference to EPA or SBA interpretation of RFA), *modified in other respect*, 195 F.3d 4 (D.C.Cir.1999), *reversed in other respect*, *Whitman v. Am. Trucking Ass'ns*, 531 U.S. 457, 121 S.Ct. 903, 149 L.Ed.2d 1 (2001).

In making its determination, the FAA relied on a line of decisions in which this court held that under the RFA the regulating agency need consider only the economic impact of agencies directly affected and regulated by the subject regulations. We find the situation here materially different from the cases the FAA cites.

Initially, in *Mid-Tex Electric Cooperative v. FERC*, 773 F.2d 327 (1985), we reviewed a challenge by wholesale customers to a rule permitting utilities to recover costs and held that "FERC correctly determined that it need not prepare a regulatory flexibility analysis" because the regulated utilities, which were subject to the rule, were not small entities, while the wholesale customers, many of whom were small entities, were not regulated by the rule. 773 F.2d at 343. We explained "it is clear that Congress envisioned that the relevant 'economic impact' was the impact of compliance with the proposed rule on regulated small entities," *id.* at 342. That is, the RFA is satisfied if the agency determines "the rule will not have a significant economic impact on a substantial number of small entities that are *subject to the requirements of the rule*." *Id.* (emphasis added). As the court noted, the Congress "did not intend to require that every agency consider every indirect effect that any regulation might have on small businesses in any stratum of the national economy." *Id.* at 343. In *Mid-Tex*, FERC was not required to consider the indirect economic effects on the wholesale customers of the utilities or on the ultimate retail consumers, neither of which was regulated by the challenged rule.

In *Cement Kiln Recycling Coalition v. EPA*, 255 F.3d 855, 868–69 (D.C.Cir.2001), our latest iteration of *Mid-Tex*, environmental groups and industry representatives challenged emission standards for hazardous waste combustors. The court rejected a cement manufacturer's argument that EPA incorrectly confined its RFA analysis to the economic effects on the hazardous waste combustion facilities, without considering the effect on generators of hazardous waste like itself. The court explained:

> EPA's rule regulates hazardous waste combustors, not waste generators. We explained in *Mid-Tex* that the language of the statute limits its application to the "small entities *which will be subject to the proposed regulation* "—that is, those "small entities *to which the*

> *proposed rule will apply.*" *Mid–Tex Elec. Coop.*, 773 F.2d at 342 (quoting 5 U.S.C. § 603(b)) (first emphasis in *Mid–Tex*; second emphasis in original). Congress "did not intend to require that every agency consider every indirect effect that any regulation might have on small businesses in any stratum of the national economy." *Id.* at 343.

255 F.3d at 869. The court further rejected the cement manufacturer's attempt to *177 distinguish its situation "on the basis that EPA actually intended to affect the conduct of hazardous waste generators by raising the cost of incineration," stating:

> [A]pplication of the RFA does turn on whether particular entities are the "targets" of a given rule. The statute requires that the agency conduct the relevant analysis or certify "no impact" for those small businesses that are "subject to" the regulation, that is, those to which the regulation "will apply."

Id. (quoting *Mid–Tex*, 773 F.2d at 342; 5 U.S.C. § 603(b)(3)).

Unlike the parties claiming economic injury in the cited cases, contractors and subcontractors are directly affected and therefore regulated by the challenged regulations. It may be true that the regulations are immediately addressed to the employer air carriers which are in fact the parties certified to operate aircraft. *See* 14 C.F.R. pt. 121, app. I §§ I(B)-(C) (making "employer" responsible party for ensuring drug program is conducted properly), II (definition of "employer"); 14 C.F.R. pt. 121, app. J §§ I(B)-(C) ("employer" responsible for alcohol testing program), I(D) (definition of employer). Nonetheless, the regulations expressly require that the employees of contractors and subcontractors be tested. *See* 14 C.F.R. pt. 121, apps. I § III, J § II. Thus, the contractors and subcontractors (at whatever tier) are entities " '*subject to the proposed regulation*'—that is, those 'small entities *to which the proposed rule will apply*.' " *Cement Kiln*, 255 F.3d at 869 (quoting *Mid–Tex*, 773 F.2d at 342 (quoting 5 U.S.C. § 603(b))) (first emphasis in *Cement Kiln*; second emphasis in original). In other words, the 2006 Final Rule imposes responsibilities directly on the contractors and subcontractors and they are therefore parties affected by and regulated by it. The FAA acknowledged as much when it advised:

> If a contractor company has FAA-regulated testing programs, *it must ensure* any individual performing a safety-sensitive function by contract (including by subcontract at any tier) below it is subject to testing. The FAA recognizes there may be multiple tiers of subcontractors in the aviation industry. *Any lower tier contractor company* with FAA-regulated testing programs *will be held responsible* for its own compliance with the FAA drug and alcohol testing regulations. Also, there may be circumstances where *the regulated employer and higher tier contractor companies share responsibility* for the lower tier contractor company's noncompliance.

2006 Final Rule, 71 Fed.Reg. at 1671–72 (emphases added). In fact, the FAA had it right in the NPRM and SNPRM when it determined that for the purpose of its RFA analysis the affected small entities should be considered to be Part 145 repair stations and their subcontractors. *See* 69 Fed.Reg. at 27,986. When the FAA abruptly changed course in the 2006 Final Rule, it went off course.

As a fall back, the FAA asserts that, in the event the court concludes contractors and subcontractors are directly regulated by the 2006 Final Rule, the FAA "substantially complied with" the RFA because it conducted initial evaluations (for the SNPRM) and a final economic evaluation of the effects on the industry, responding to comments following the SNPRM. The final evaluation, however, was not a "final regulatory flexibility analysis" pursuant to the RFA as the FAA determined that contractors and subcontractors are not regulated entities for the purpose of the RFA. *See* 71 Fed.Reg. at 1673; JA 155. Further, the RFA expressly requires that the final regulatory flexibility analysis explain *178 "why each one of the other significant alternatives to the rule considered by the agency which affect the impact on small entities was rejected." 5 U.S.C. § 604(a)(5). The evaluation on which the FAA relies, however, states unequivocally:

"[N]o alternatives were considered." JA 100. The RFA is a procedural statute setting out precise, specific steps an agency must take. The FAA offers no authority to support its "substantial compliance" theory and we are aware of none. Accordingly we reject this argument as well.

For the foregoing reasons, we uphold the substance of the FAA's 2006 Final Rule and remand for the limited purpose of conducting the analysis required under the Regulatory Flexibility Act, treating the contractors and subcontractors as regulated entities. [10]

10 In light of the public's manifest interest in aviation safety, we will not defer enforcement of the rule against small entities pending the FAA's Regulatory Flexibility Act analysis. *See* 5 U.S.C. § 611(a)(4)(B).

So ordered.

SENTELLE, Circuit Judge, dissenting:

I respectfully dissent from the majority's holding that the Omnibus Transportation Employee Testing Act authorizes the FAA to require drug and alcohol testing of employees who perform the enumerated functions "directly or by contract (including by subcontract at any tier)." 2006 Final Rule, 71 Fed.Reg. 1666, 1676, 1677 (Jan. 10, 2006); *see* Maj. Op. at 165–70. I would therefore grant the petitions and vacate the 2006 Final Rule.

As originally enacted in 1991, the Act provided that the FAA "shall" require drug and alcohol testing of "airmen, crewmembers, airport security screening contract personnel, and other air carrier employees responsible for safety-sensitive functions ..." Pub.L. No. 102–143, tit. v, § 3, 105 Stat. 917, 953 (Oct. 28, 1991) (codified at 49 U.S.C. app. 1434; recodified, as amended, at 49 U.S.C. § 45102(a)(1)). To find statutory authority for the Rule, the FAA must argue that employees of subcontractors "at any tier" are "air carrier employees" under the Act. I think it is plain that they are not, and therefore cannot join my colleagues in holding that the Act is ambiguous under *Chevron U.S.A., Inc. v. Natural Resources Defense Council, Inc.*, 467 U.S. 837, 104 S.Ct. 2778, 81 L.Ed.2d 694 (1984).

The question is whether "Congress has directly spoken to the precise question at issue." *Id.* at 842, 104 S.Ct. 2778. To my mind, the plain language of the statute forecloses the interpretation urged by the FAA. An employee is "[a] person who works in the service of another person (the employer) under an express or implied contract of hire, under which the employer has the right to control the details of work performance." BLACK'S LAW DICTIONARY 543 (7th ed.1999). This is not the only meaning of the word, but "definitional possibilities" do not alone create ambiguity. *See California Indep. Sys. Operator Corp. v. FERC*, 372 F.3d 395, 400 (D.C.Cir.2004) ("*CAISO*") (citing *Brown v. Gardner*, 513 U.S. 115, 118, 115 S.Ct. 552, 130 L.Ed.2d 462 (1994)). Here, we need not canvass all known uses of the word "employee" to know that an employee of a subcontractor performing work for a contractor which in turn has a contract with an air carrier is not, in an ordinary sense, an "air carrier employee." And the Final Rule does not stop at that—it applies to employees of subcontractors "at any tier."

The majority argues that because the original Act authorized testing of certain contractors' employees (namely, "airport security screening contract personnel"), ***179** the subsequent phrase "and *other* air carrier employees" may be read to include *other* contractors' and subcontractors' employees. *See* Maj. Op. at 166–67. Because "employee" is not easily defined to encompass an employee of an air carrier's contractor's subcontractor, this is not a natural reading of the statute. Where "the text and reasonable inferences from it give a clear answer against the government ... that ... is 'the end of the matter.' " *CAISO*, 372 F.3d at 401 (quoting *Brown*, 513 U.S. at 120, 115 S.Ct. 552). To the extent that statutory context may fairly illuminate the reach of "air carrier employee," the reasonable inference from the phrase "airport security screening contract personnel" is that where Congress intended the Act to reach non-air carrier employees, it said so explicitly.

The FAA supports its interpretation by asserting that Congress gave it broad authority to prescribe regulations the FAA "finds necessary for safety in air commerce" and to require drug testing "[i]n the interest of aviation safety." 49 U.S.C. §§ 44701(a)(5); 45102(a)(1). No doubt the Final Rule is intended to promote safety, but Congress's mandate does not give the FAA carte blanche to pursue that goal. *See Michigan v. EPA*, 268 F.3d 1075, 1084 (D.C.Cir.2001). The FAA's authority to require drug testing is defined by statute, and in my view the FAA has exceeded that statutory authority here.

All Citations

494 F.3d 161, 377 U.S.App.D.C. 329, 26 IER Cases 660, 2005 O.S.H.D. (CCH) P 32,899

453 F.Supp.2d 116
United States District Court,
District of Columbia.

NATIONAL ASSOCIATION OF HOME BUILDERS, et al., Plaintiffs,
v.
UNITED STATES ARMY CORPS OF ENGINEERS, et al., Defendants.

No. CIV. 00-379 RJL.
|
Sept. 29, 2006.

Synopsis
Background: Association of homebuilders brought action against United States Army Corps of Engineers challenge nationwide permits (NWPs) issued under Clean Water Act (CWA). The district court, 297 F.Supp.2d 74, granted summary judgment for the Corps. The Court of Appeals, 417 F.3d 1272, reversed in part and remanded. On remand, the Corps brought motion for summary judgment.

Holdings: The District Court, Leon, J., held that:

[1] particulars of modified and reissued nationwide permits and general conditions (GCs) were logical outgrowth of proposed NWPs and GCs;

[2] performance of regionalized analysis of "minimal adverse environmental effects" that NWPs would have on environment was not arbitrary, capricious, or abuse of discretion;

[3] Corps did not act arbitrarily or capriciously or contrary to law by not defining term "minimal adverse environmental effect" in process of issuing NWPs;

[4] setting of one-half acre limit on project impacts and one-tenth acre pre-construction notice (PCN) requirement in NWPs was not arbitrary and capricious;

[5] GC, which barred use of certain NWPs in entire 100 year floodplain below headwaters and in floodway of 100 year floodplain above headwaters, was not arbitrary and capricious;

[6] requirement in NWP to establish and maintain vegetated buffers when practicable was reasonably related to discharges of dredged or fill material;

[7] applicant for NWP could not avoid NWP-specific requirements to obtain NWP by complying with state limitations and requirements; and

[8] Corps did not act arbitrarily or capriciously in issuing single NWP to regulate aggregate and hard rock or mineral mining.

Motion granted.

West Headnotes (14)

[1] **Environmental Law**
Notice and comment

Particulars of modified and reissued nationwide permits (NWPs) and general conditions (GCs) under Clean Water Act (CWA) were logical outgrowth of proposed NWPs and GCs; although NWPs that were modified, issued, and re-issued were not exactly the same as proposed NWPs eventually issued and re-issued, they did not have to be identical in order to be logical outgrowth of proposals, adequate notice and opportunity for comment had been provided before issuance of NWPs and GCs, interested parties were on notice that there would be changes to particular aspects of NWPs, and they were aware of what aspects of proposed NWPs and GCs were under consideration and that changes and modifications to NWPs and GCs were imminent. 5 U.S.C.A. § 553; Federal Water Pollution Control Act, § 404, 33 U.S.C.A. § 1344.

Cases that cite this headnote

[2] **Administrative Law and Procedure**
Notice and comment, necessity

Administrative Law and Procedure
Notice and comment, sufficiency

Agency satisfies obligation under the Administrative Procedure Act (APA) to provide advance notice of proposed rulemaking, and need not conduct further round of public comment, as long as its final rule is logical outgrowth of proposed rule originally noticed. 5 U.S.C.A. § 553(b)(3).

Cases that cite this headnote

[3] **Administrative Law and Procedure**
Notice and comment, sufficiency

Under the Administrative Procedure Act (APA), a rule is deemed a logical outgrowth, for purpose of the advance notice requirement, if interested parties should have anticipated that the change was possible, and thus reasonably should have filed their comments on the subject during the notice-and-comment period; the key focus in assessing logical outgrowth is whether the purposes of notice and comment have been adequately served. 5 U.S.C.A. § 553(b)(3).

Cases that cite this headnote

[4] **Administrative Law and Procedure**
Notice and comment, sufficiency

Under the Administrative Procedure Act (APA), a final rule is not necessarily invalid for lack of notice simply because the position it adopts differs somewhat from the position in the proposed rule. 5 U.S.C.A. § 553(b)(3).

Cases that cite this headnote

[5] **Environmental Law**
Discharge or deposit of dredged or fill material

Performance of regionalized analysis of "minimal adverse environmental effects" that nationwide permits (NWPs) under Clean Water Act (CWA) would have on environment was not arbitrary, capricious, or abuse of discretion; United States Army Corps of Engineers, in essence, reasonably concluded that questions necessitating technical certainty should be developed at local level, not national level, by setting baseline that was low and more protective of navigable waters of United States against discharge of pollutants. Federal Water Pollution Control Act Amendments of 1972, § 101(a), 33 U.S.C.A. § 1251(a); Federal Water Pollution Control Act, § 404, 33 U.S.C.A. § 1344; 5 U.S.C.A. § 706(2)(E).

Cases that cite this headnote

[6] **Administrative Law and Procedure**
Substantial evidence

When deciding under the Administrative Procedure Act (APA) if there is substantial evidence in the record to support an agency's position, a court's analysis is limited to determining whether the agency's decision was rational and based on consideration of the relevant factors. 5 U.S.C.A. § 706(2)(E).

Cases that cite this headnote

[7] **Environmental Law**
Discharge or deposit of dredged or fill material

Issuance of general permits under the Clean Water Act (CWA) is a discretionary decision of the United States Army Corps of Engineers. Federal Water Pollution Control Act, § 404, 33 U.S.C.A. § 1344.

Cases that cite this headnote

[8] **Environmental Law**
Discharge or deposit of dredged or fill material

United States Army Corps of Engineers did not act arbitrarily or capriciously or contrary to law by not defining term "minimal adverse environmental effect," in process of issuing nationwide permits (NWPs) under provision in Clean Water Act (CWA); due to diversity of aquatic environments of waters of United States, what was minimally adverse environmental impact in Arizona, would not have had same effect on bayous of Louisiana. Federal Water Pollution Control

Act Amendments of 1972, § 101(a), 33 U.S.C.A. § 1251(a); Federal Water Pollution Control Act, § 404, 33 U.S.C.A. § 1344; 5 U.S.C.A. § 706(2)(E).

Cases that cite this headnote

[9] **Environmental Law**

Discharge or deposit of dredged or fill material

Setting of one-half acre limit on project impacts and one-tenth acre pre-construction notice (PCN) requirement in nationwide permits (NWPs) under Clean Water Act (CWA) was not arbitrary and capricious; United States Army Corps of Engineers used its expertise to determine that one-half acre limit and one-tenth acre PCN requirement were best limitations and requirements to include in NWPs to ensure that only "minimal adverse environmental effects" were caused in discharge of pollutants. Federal Water Pollution Control Act, § 404, 33 U.S.C.A. § 1344.

Cases that cite this headnote

[10] **Environmental Law**

Discharge or deposit of dredged or fill material

General condition (GC), which barred use of certain nationwide permits (NWPs) under Clean Water Act (CWA) in entire 100 year flood plain below headwaters and in floodway of 100 year flood plain above headwaters, was not arbitrary and capricious; Corps adequately explained changes made to GC which included why GC would use 100 year flood plains identified by Flood Insurance Rate Maps or local flood plain maps approved by Federal Emergency Management Agency (FEMA), how GC reinforced FEMA program to minimize impacts to flood plains, how GC would strengthen flood plain policy and reduce flood damages, and why prohibitions outlined in GC were removed from certain NWPs. Federal Water Pollution Control Act, § 404, 33 U.S.C.A. § 1344.

Cases that cite this headnote

[11] **Environmental Law**

Discharge or deposit of dredged or fill material

Requirement in nationwide permit (NWP) issued under Clean Water Act (CWA) to establish and maintain vegetated buffers when practicable was reasonably related to discharges of dredged or fill material; permit conditions were valid if they were reasonably related to discharge, whether directly or indirectly, and United States Army Corps of Engineers believed that vegetated buffers were critical element of overall aquatic ecosystem in virtually all watersheds. Federal Water Pollution Control Act, § 404, 33 U.S.C.A. § 1344.

1 Cases that cite this headnote

[12] **Environmental Law**

Discharge or deposit of dredged or fill material

Applicant for nationwide permit (NWP) could not avoid NWP-specific requirements to obtain NWP by complying with state limitations and requirements, since United States Army Corps of Engineers had authority under Clean Water Act (CWA) to require applicant for NWP to provide water quality management measures that would ensure that authorized work did not result in more than minimal degradation of water quality and Corps had authority to ensure that discharging of dredged or fill material caused only minimal adverse environmental effects; state limitations and requirements, as related to water quality, become part of federal permit but did not supplant federal requirements. Clean Water Act, § 401(a)(1), (b, d), 33 U.S.C.A. § 1341(a)(1), (b, d).

2 Cases that cite this headnote

[13] **Environmental Law**
Discharge or deposit of dredged or fill material

United States Army Corps of Engineers did not act arbitrarily or capriciously in issuing single nationwide permit (NWP) under Clean Water Act (CWA) to regulate aggregate and hard rock or mineral mining, on basis that those activities were similar in nature; precise standards did not exist for determining what constituted activities that were similar in nature, both activities were forms of mining, Corps treated mining activities differently where they differed, and Corps had broad discretion in sorting activities as similar in nature. Federal Water Pollution Control Act, § 404(e)(1), 33 U.S.C.A. § 1344(e)(1).

1 Cases that cite this headnote

[14] **Environmental Law**
Discharge or deposit of dredged or fill material

Limiting use of particular nationwide permit (NWP) under Clean Water Act (CWA) to construction of single family residence by person who would live in that home was not arbitrary and capricious; allowing NWP to be used by contractors and developers would have increased use of NWP and, therefore, increased impact to environment as result. Federal Water Pollution Control Act, § 404(e)(1), 33 U.S.C.A. § 1344(e)(1).

Cases that cite this headnote

Attorneys and Law Firms

*119 Rafe Petersen, Lawrence R. Liebesman, Holland & Knight, L.L.P., Virginia S. Albrecht, Karma B. Brown, Hunton & Williams LLP, Washington, DC, for Plaintiffs.

Martin F. McDermott, U.S. Department of Justice, Washington, DC, for Defendants.

MEMORANDUM OPINION

LEON, District Judge.

Before the Court on remand are the parties' Cross–Motions for Summary Judgment. In these three consolidated cases,[1] the plaintiffs[2] challenge nationwide *120 permits ("NWPs") issued under Section 404(e) of the Clean Water Act ("CWA") by the defendant U.S. Army Corps of Engineers ("Corps") in March 2000 and January 2002. After considering the parties motions, the opposition thereto, oral argument, supplemental briefing on the surviving claims, and the record, the Court GRANTS all defendants Cross–Motions for Summary Judgment and DENIES all plaintiffs' Cross–Motions for Summary Judgment.

1 The two other consolidated actions are: *National Federation of Independent Business v. U.S. Army Corps of Engineers*, Civ. Action No. 00–1404 and *National Stone, Sand & Gravel Association v. U.S. Army Corps of Engineers*, Civ. Action No. 00–558.

2 The plaintiffs in this case are the National Association of Home Builders ("NAHB"), the National Stone, Sand and Gravel Association ("NSSGA"), the American Road and Transportation Builders Association ("ARTBA"), the Nationwide Public Projects Coalition ("NPPC"), the National Federation of Independent Business ("NFIB"), and Wayne Newman.

BACKGROUND[3]

3 This Background section is adapted from the Background section found in *National Association of Home Builders v. U.S. Army Corps of Engineers*, 297 F.Supp.2d 74, 76–78 (D.D.C.2003).

Congress enacted the CWA to "restore and maintain the chemical, physical, and biological integrity of the Nation's waters." 33 U.S.C. § 1251(a). To that end, the CWA prohibits a party from discharging pollutants, such as dredged or fill material, into navigable waters of the United States. *Id.* § 1311(a). Under the CWA, however, the Corps is authorized to allow such discharges through the issuance of permits, both general and individual. *Id.* § 1344. The purpose of general permits, including

nationwide permits ("NWP"), issued under Section 404(e) of the CWA is to allow projects that cause minimal environmental impact to go forward with little delay or paperwork. 33 C.F.R. § 330.1(b) (explaining that general permits are "designed to regulate with little, if any, delay or paperwork certain activities having minimal impacts"). If a proposed activity meets the conditions for general permits, it need not be subjected to the individualized permit process through which the Corps makes determinations on discharges on a case-by-case basis. 33 U.S.C. § 1344. Specifically, Section 404(e) states that:

> the Secretary may, after notice and opportunity for public hearing, issue general permits on a State, regional, or nationwide basis for any category of activities involving discharges of dredged or fill material if the Secretary determines that the activities in such category are similar in nature, will cause only minimal adverse environmental effects when performed separately, and will have only minimal cumulative adverse effect on the environment.

Id. § 1344(e)(1). Thus, the Corps has the discretion to issue such general permits if the polluting activities are similar in nature and will only cause minimal environmental effects. *Id.* If a party discharges pollutants into navigable waters without meeting the conditions of a general permit or otherwise acquiring an individual permit, then the party can be subject to enforcement actions, such as a civil administrative action by the Corps or a civil and criminal proceeding by the Department of Justice. *Id.* § 1319(g); 33 C.F.R. §§ 326.5–326.6.

For five-year intervals, beginning in 1977, the Corps has issued NWPs, including the most widely used permit, NWP 26. 61 Fed.Reg. 65,874, 65,893 (Dec. 13, 1996). Before the relevant changes to the NWPs made in 2000, NWP 26 authorized discharges that affected up to ten acres of waters without requiring a party to acquire an individual permit, and required that a party notify a Corps' district engineer of any discharges causing loss or substantial adverse modification of one to ten acres of wetlands (this second requirement is known as a "pre-construction notification"). 61 Fed.Reg. 30,781, 30,783 (June 17, 1996). On June 17, 1996, the ***121** Corps proposed reissuing many of the NWPs, including NWP 26, which was to expire on January 21, 1997. *Id.* at 30,780. On December 13, 1996, the Corps reissued NWP 26 for a period of two years, with somewhat different conditions. 61 Fed.Reg. at 65,874, 65,877, 65,891, 65,895. In July 1998, the Corps published its proposed replacement permits, and extended the term of NWP 26 again. 63 Fed.Reg. 36,040 (July 1, 1998). Following a public comment period in which it received approximately 10,000 comments on the proposal, 64 Fed.Reg. 39,257 (July 21, 1999), the Corps set forth a second proposal regarding the other new permits in July 1999. *See* 64 Fed.Reg. 39,252 (July 21, 1999). On March 9, 2000, after considering even more comments, the Corps issued the permits that replaced NWP 26. *See* 65 Fed.Reg. 12,818, 12,818 (Mar. 9, 2000).

Overall this process resulted in five new NWPs (known collectively as "Replacement Permits"), modification of six existing NWPs, two new General Conditions ("GC"), and modification of nine existing GCs. *Id.* These changes to the NWPs process authorized many of the same activities allowed under NWP 26, but the new and modified NWPs were activity-specific. *See id.* Among the controversial changes, the Corps narrowed the maximum per-project acreage impact from ten acres to a half acre, and pre-construction notification was required for impacts greater than one-tenth of an acre instead of one acre.[4] The new NWPs became effective on June 7, 2000, and NWP 26 expired the same day. 65 Fed.Reg. 14,255, 14,255 (Mar. 16, 2000).

4 Other changes include the following: (1) NWP 29 (single family housing) was modified to reduce acreage limitation to 1/4-acre and required preconstruction notification for all activities; (2) NWPs 39, 40, 42, and 43 were modified to include a 300-linear foot limit for filling or excavation activities in stream beds that normally have flowing water; (3) GC 25 was added to restrict use of certain NWPs in designated critical resource waters; (4) GC 26 was added to limit use of certain NWPs to place permanent, above-grade fills in some areas of 100-year floodplains; (5) GCs 9 and 19 were modified to add additional water quality protections, such as the use of vegetated buffers and water quality management plans; and (6) GC 13 was modified to include a thirty-day completeness review period of Corps' review of preconstruction notifications. *See* 65 Fed.Reg. at 12,818.

NAHB's complaint was filed on February 28, 2000, and on March 16, 2000, NSSGA filed its complaint. The two cases were consolidated on June 15, 2000. NFIB filed its complaint on June 16, 2000, and was consolidated with the other two cases on September 12, 2000. The plaintiffs argue, *inter alia*, that the NWPs exceed the Corps' authority under the CWA because the Corps only has jurisdiction over "discharges" of "pollutants," including dredged or fill material, into "waters of the United States," the NWPs exceed the Corps' authority under the CWA because the Corps can only issue NWPs for categories of activities that are similar in nature and will cause only minimal adverse environmental impacts, that the Corps acted arbitrarily and capriciously in the issuance of the replacement permit NWPs, that the Corps did not conduct a flexibility analysis as required by the Regulatory Flexibility Act ("RFA"), 5 U.S.C. §§ 601 *et. seq.*, and that the NWPs violated the National Environmental Policy Act ("NEPA"), 42 U.S.C. §§ 4321 *et. seq.*, because the Corps did not conduct a Programmatic Environmental Impact Statement. [5] On February 15, 2001, all three sets of plaintiffs filed motions for summary judgment, and the defendants ***122** and intervenors responded with cross-motions for summary judgment on June 14, 2001.

5 Plaintiff NSSGA's Complaint additionally contained claims alleging violations of the Tenth Amendment by defendant, but these claims were later withdrawn. (*See* Notice of Filing of Additional Authorities, Nov. 4, 2003.)

While the parties' cross-motions for summary judgment were pending, on January 15, 2002, the Corps re-issued all existing NWPs and GCs with some modifications. *See* 67 Fed.Reg.2020 (Jan. 15, 2002). Because the NWPs were reissued, the Court to which the case was initially assigned permitted the parties to submit supplemental complaints and pleadings. While that supplemental briefing was in progress, this case was reassigned to this Court on April 9, 2002. The parties completed their supplemental filings on August 12, 2002. On November 26, 2003, this Court ruled that the "Corps' issuance of the new NWPs and GCs, while constituting the completion of a decisionmaking process, does not constitute a 'final' agency action because no legally binding action has taken place as to any given project until either an individual permit application is denied or an enforcement action is instituted." *Nat'l Ass'n of Home Builders*, 297 F.Supp.2d at 78. Our Circuit Court, on July 29, 2005, reversed and remanded this Court's ruling on the Administrative Procedures Act ("APA"), 5 U.S.C. §§ 551 *et. seq.*, and RFA claims, and affirmed this Court's dismissal of the NEPA claims. *Nat'l Ass'n of Home Builders v. U.S. Army Corps of Eng'rs*, 417 F.3d 1272, 1289 (D.C.Cir.2005). Specifically, our Circuit Court found that the NWPs issued by the Corps constituted final agency action subject to challenge under the APA, *id.* at 1281, and that the APA challenge to the NWPs is "ripe for judicial review," *id.* at 1284. Our Circuit Court also found that the Corps' issuance of the NWPs constituted final agency action in the form of a legislative rule, that plaintiffs' challenge focused on the Corps' compliance with sections 604 and 605 of the RFA, *id.* at 1285–86, and that the claim was ripe for review, *id.* at 1286. As the case was remanded to this Court for further proceedings consistent with the ruling of our Circuit Court, supplemental pleadings were filed by the parties, and this Court held oral argument on the remaining claims on January 30, 2006. [6] *Id.* at 1274–75.

6 On January 5, 2006, Counsel for the Corps, NAHB, and NFIB jointly submitted to the Court a Motion for Partial Consent Judgment on the RFA claims brought by NAHB and NFIB. (Dkt.# 137.) NSSGA did not object to this motion, and intervenor-defendants National Resources Defense Council ("NRDC") and the Sierra Club stated in the motion: "Without consenting to any judgment against NRDC and Sierra Club, without endorsing the characterizations contained in the motion for partial consent judgment and accompanying proposed order, and without waiving any rights, NRDC and Sierra Club do not oppose the relief requested in said motion." (*Id.* at 2–3.)

STANDARD OF REVIEW

I. Summary Judgment

Summary judgment is appropriate when the pleadings and the record demonstrate that "there is no genuine issue as to any material fact and that the moving party is entitled to judgment as a matter of law." Fed.R.Civ.P. 56(c). The moving party bears the initial burden of demonstrating the absence of a genuine dispute of material fact, *Celotex Corp. v. Catrett*, 477 U.S. 317, 323, 106 S.Ct. 2548, 91 L.Ed.2d 265 (1986), and the Court draws all reasonable inferences regarding the assertions made in a light favorable to the non-moving party, *Biodiversity Conservation Alliance v. U.S. Bureau of Land Mgmt.*, 404 F.Supp.2d 212, 216 (D.D.C.2005) (citing *Flynn v.*

Dick Corp., 384 F.Supp.2d 189, 192–93 (D.D.C.2005)). "[W]hen ruling on cross-motions for summary judgment, the Court shall grant summary judgment only if one of the moving parties is entitled to ***123** judgment as a matter of law upon material facts that are not genuinely disputed." *Barr Labs., Inc. v. Thompson*, 238 F.Supp.2d 236, 244 (D.D.C.2002) (citing *Rhoads v. McFerran*, 517 F.2d 66, 67 (2d Cir.1975)).

In ruling on the merits of an administrative decision on a claim brought under the APA, the Court must look to the administrative record. *See Richards v. INS*, 554 F.2d 1173, 1177 (D.C.Cir.1977). Because of this, no additional fact-finding is necessary and summary judgment is appropriate. *See Young v. Gen. Servs. Admin.*, 99 F.Supp.2d 59, 65 (D.D.C.2000); *Lun Kwai Tsui v. Att'y Gen. of the U.S.*, 445 F.Supp. 832, 835 (D.D.C.1978) ("[S]ummary judgment is appropriate after a review of the administrative record.").

II. APA Review

In actions brought under the APA, an agency's final rule or action will be upheld unless it is "arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with law." 5 U.S.C. § 706(2)(A); *see Thomas Jefferson Univ. v. Shalala*, 512 U.S. 504, 512, 114 S.Ct. 2381, 129 L.Ed.2d 405 (1994); *see also Envtl. Integrity Project v. EPA*, 425 F.3d 992, 995 (D.C.Cir.2005). "The scope of review under the 'arbitrary and capricious' standard is narrow and a court is not to substitute its judgment for that of an agency." *Motor Vehicle Mfrs. Ass'n of U.S., Inc. v. State Farm Mut. Auto. Ins. Co.*, 463 U.S. 29, 43, 103 S.Ct. 2856, 77 L.Ed.2d 443 (1983) ("*Motor Vehicle Mfrs.*"). A court must also set aside an agency decision if it lacks "substantial evidence" in the record to support the conclusion. 5 U.S.C. § 706(2)(E); *A.T. & T. Corp. v. FCC*, 86 F.3d 242, 247 (D.C.Cir.1996). This is a highly deferential standard of review. *See id.* Under Section 553 of the APA, when promulgating an agency rule, the agency must provide adequate notice and opportunity to comment on the proposed rule. 5 U.S.C. § 553. If the agency fails to provide this notice and opportunity to comment or the notice and comment period is inadequate, the "regulation must fall on procedural grounds, and the substantive validity of the change accordingly need not be examined." *AFL–CIO v. Donovan*, 757 F.2d 330, 338 (D.C.Cir.1985).

DISCUSSION

[1] Plaintiffs raise a myriad of challenges to the Corps' issuance of the replacement NWPs and GCs in 2000 and the re-issuance of the NWPs and General Conditions in 2002 and several underlying claims. The main claims, however, can be boiled down to the following: 1) that the Corps did not provide adequate notice and opportunity to comment before issuing the NWPs challenged by plaintiffs and that the NWPs and GCs are not the logical outgrowth of the proposals; 2) that the Corps acted arbitrarily and capriciously and abused its discretion in performing a regionalized analysis of the "minimal adverse environmental effects" the NWPs would have on the environment; 3) that the Corps did not provide a reasonable basis for the acreage limitations and pre-construction notification requirements for NWPs; 4) that the restrictions in the use of NWPs in the 100–year floodplains were arbitrary and capricious and are not consistent with the Corps' authority; 5) that the regulation of aggregate and hard rock/mineral mining as activities "similar in nature" is arbitrary and capricious; 6) that the Corps did not have the statutory authority to condition NWPs to assure protection of water quality; 7) that the utilization of vegetated buffers in mitigation as referenced in GC 19 is not reasonably related to the disposal of dredged and fill material and, therefore, is beyond the Corps' authority; and 8) that the issuance ***124** of NWP 29 is arbitrary and capricious.[7] The Corps counters, in essence, that the issuance of the replacement NWPs and GCs and the re-issuance of the NWPs and GCs in 2002 were in accordance with Section 404 of the CWA, were proper under the APA, and were neither arbitrary and capricious, nor contrary to law. For the following reasons, the Court agrees with the Corps and GRANTS its motion for summary judgment.

7 The following claims of the plaintiffs will be addressed in footnotes: 1) that the Supreme Court's decision in *Solid Waste Agency of Northern Cook County v. U.S. Army Corps of Engineers* ("*SWANCC* "), 531 U.S. 159, 121 S.Ct. 675, 148 L.Ed.2d 576 (2001), necessitates a remand of the NWPs and the GCs to the Corps for reconsideration of the permits in light of the guidance provided in that decision as to the Corps' jurisdictional limits; 2) that the NWPs addressing excavation activities exceed the Corps' authority; 3) that the NWPs and the GCs promulgated by the

Corps violate the "streamlining" of the permit process as required by the CWA; 4) that the Corps violated Section 404(e)(2) of the CWA when it revoked and modified NWP 26; and 5) the request that the Court reinstate NWP 26 while the matter is on remand before the Corps for reconsideration in light of the Court's ruling.

I. The Corps Did Provide Adequate Notice and Opportunity to Comment Before Issuing the NWPs Challenged by the Plaintiffs and the NWPs Are the Logical Outgrowth of the Proposals.

Plaintiffs allege that the Corps "failed to afford the public adequate opportunity to comment" on the Replacement Permit Rule, the Replacement Permits, the Replacement GCs, the Reissued Permits, and the Reissued GCs. In particular, plaintiffs allege that the final Replacement Permits and Reissued Permits were not the logical outgrowth of the proposed permits in regard to the acreage limitations placed on certain NWPs. (Pls. NSSGA's, ARTBA's, & NPPC's Mem. Supp. Pls.' Mot. Summ. J. 41–44 ("NSSGA's Mem.").) The Corps contends that plaintiffs were on notice of the possible changes to the NWPs and GCs and, in particular, that the acreage limitations would be reduced, and, thus, the issuance of NWPs with lower acreage limitations is a logical outgrowth of the proposed NWPs. (Mem. P. & A. Supp. Def.'s Cross–Mot. Summ. J. & in Opp'n Pls.' Mots. Summ. J. 76–79 ("Corps' Mem.").) For the following reasons, the Court agrees with the Corps that adequate notice and opportunity for comment were provided before the issuance of the NWPs and GCs, and that the particulars of the NWPs, including the smaller acreage limitations of NWPs 43 and 44, are the logical outgrowth of the proposed NWPs and GCs.

When an agency seeks to promulgate a rule, or in this case a NWP or GC under the CWA, the APA requires that the agency publish notice of the rule in the Federal Register and then give interested parties an opportunity to comment. 5 U.S.C. § 553. The notice must contain "either the terms or substance of the proposed rule or a description of the subjects and issues involved." *Id.* § 553(b)(3). If notice is inadequate, the "regulation must fall on procedural grounds, and the substantive validity of the change accordingly need not be examined." *AFL CIO v. Donovan*, 757 F.2d at 338.

[2] [3] [4] An agency satisfies the notice requirement when the final rule constitutes a "logical outgrowth" of the proposed rule. *Ne. Md. Waste Disposal Auth. v. EPA*, 358 F.3d 936, 951–52 (D.C.Cir.2004). "A rule is deemed a logical outgrowth if interested parties 'should have anticipated' that the change was possible, and thus reasonably should have filed their comments on ***125** the subject during the notice-and-comment period." *Id.* at 952 (quoting *City of Waukesha v. EPA*, 320 F.3d 228, 245 (D.C.Cir.2003)). Furthermore, the key focus in assessing logical outgrowth is "whether the purposes of notice and comment have been adequately served." *Fertilizer Inst. v. EPA*, 935 F.2d 1303, 1311 (D.C.Cir.1991). Our Circuit has stated that "[t]his means that a final rule will be deemed the logical outgrowth of the proposed rule if a new round of notice and comment would not provide commentators with 'their first occasion to offer new and different criticisms which the agency might find convincing.' " *Id.* (quoting *United Steelworkers of Am. v. Marshall*, 647 F.2d 1189, 1225 (D.C.Cir.1980)). If a "final rule deviates too sharply from the proposal, affected parties will be deprived of notice and an opportunity to respond to the proposal." *AFL CIO*, 757 F.2d at 338 (quoting *Small Refiner Lead Phase–Down Task Force v. EPA*, 705 F.2d 506, 547 (D.C.Cir.1983)). A final rule is not necessarily invalid for lack of notice, however, simply because the position it adopts differs somewhat from the position in the proposed rule. *AFL CIO*, 757 F.2d at 338.

Our Circuit, in *Environmental Integrity Project v. EPA*, 425 F.3d 992 (D.C.Cir.2005), stated that a final rule is not the logical outgrowth of the proposed rule if the agency's final rule is the *opposite* of the proposed rule. *Id.* at 998. Our Circuit noted that it has "refused to allow agencies to use the rulemaking process to pull a surprise switcheroo on regulated entities." *Id.* at 996. The Court added, "[i]f the APA's notice requirements mean anything, they require that a reasonable commenter must be able to trust an agency's representations about *which particular* aspects of its proposal are open for consideration." *Id.* at 998 (emphasis in original). In that case, our Circuit vacated the final rule because a logical outgrowth of a proposed rule "does not include the Agency's decision to repudiate its proposed interpretation and adopt its inverse." *Id.*

On June 17, 1996, the Corps published a "Notice of Intent and Request for Comments" concerning the re-issuance of existing NWPs and GCs, and the issuance of four new NWPs. 61 Fed.Reg. at 30,780. In response to this notice, the Corps received over "4,000 comment documents." 61 Fed.Reg. at 65,875. In response to the Corps' July 1, 1998

"Notice of Intent and Request for Comments" concerning the issuance of six new NWPs and modifying six existing NWPs after NWP 26 expired, *see* 63 Fed.Reg. 36,040, 36,040 (July 1, 1998), the Corps' additional modifications to the proposed NWPs on October 14, 1998, *see* 63 Fed.Reg. 55,095 (Oct. 14, 1998), and the additions to the proposal issued on July 21, 1999, *see* 64 Fed.Reg. at 39,252, the Corps extended the forty-five-day comment period an additional thirty days. 65 Fed.Reg. at 12,818. Public hearings on the July 1, 1998 Notice were held across the country and a public hearing was held on August 19, 1998, in Washington, D.C. 65 Fed.Reg. at 12,824. In response to the August 9, 2001 "Notice of Intent and Request for Comment," *see* 66 Fed.Reg. 42,070 (Aug. 9, 2001), which reissued the NWPs and the GCs along with some modifications to definitions within, the Corps received "over 2,100 comments and had 19 people attend" the September 26, 2001 public hearing in Washington, D.C. 67 Fed.Reg. at 2027. Therefore, plaintiffs and other interested parties had adequate notice and opportunity to comment on the modifications, issuance, or re-issuance of the NWPs and GCs.

The main issue here is whether the particulars of the modified and reissued NWPs and GCs were the logical outgrowth of the proposed NWPs and GCs. While the NWPs that were modified, issued, and re- ***126** issued are not *exactly* the same as the proposed NWPs eventually issued and re-issued, *compare* 64 Fed.Reg. 39,252 (July 21, 1999) *with* 65 Fed.Reg. 12818 (Mar. 9, 2000), *compare* 66 Fed.Reg. 42,070 (Aug. 9, 2001) *with* 67 Fed.Reg.2020 (Jan. 15, 2002), they do not have to be identical in order to be a logical outgrowth of the proposals, *see AFL CIO*, 757 F.2d at 338. Plaintiffs and other interested parties were on notice that there would be changes to "particular aspects" of the NWPs, including the acreage limitations, and that the changes would most likely lead to a reduction in the acreage limitations. *See Envtl. Integrity Project*, 425 F.3d at 998. Plaintiffs were also aware of what aspects of the proposed NWPs and GCs were under consideration. *See id.*

Specifically as to NWP 43, while the Corps did state in its July 21, 1999 Notice that it was "proposing to retain the 2 acre limit for the construction of new SWM facilities" under NWP 43, 64 Fed.Reg. at 39,327, the fact is that the Corps was considering lowering the acreage limit and a limit below two acres was being considered ("commenters recommended acreage limits for the construction of new SWM facilities, which ranged from 1 to 5 acres") and, therefore, the lower acreage limit is a logical outgrowth of the proposal. *Id.* In regard to NWP 44, while the Corps proposed a "2 acre limit for a single and complete mining project" in the July 21, 1999 Notice, again, several options were being considered (including a sliding scale), and the final lower acreage limit was a logical outgrowth of the proposal and interested parties were on notice of this possible outcome. *See id.* at 39,332.

The notices and requests for comments released by the Corps made all interested parties aware that changes and modifications to the NWPs and GCs were imminent. Just because the final NWPs contained lower acreage limits than the Corps' initial proposals does not mean *per se* that they are not the logical outgrowths of the proposals. *See AFL CIO*, 757 F.2d at 338. All interested parties were aware that the final NWPs and GCs would be more protective of the environment and the waters of the United States; hence, a more protective NWP or GCs is a logical endpoint, especially considering the fact that the objective of the CWA is "to restore and maintain the chemical, physical, and biological integrity of the Nation's waters." 33 U.S.C. § 1251(a). Accordingly, plaintiffs' claim that the Corps violated the notice and opportunity for adequate comment requirements of the APA and the CWA, 33 U.S.C. § 1344(e)(1), is not persuasive.

II. The Corps Did Not Act Arbitrarily or Capriciously or Abuse Its Discretion in Performing a Regionalized Analysis of the "Minimal Adverse Environmental Effects" the NWPs Would Have on the Environment.

[5] Plaintiffs allege that the Corps acted arbitrarily and capriciously, and abused its discretion, in performing a regionalized analysis of the "minimal adverse environmental effects" the NWPs would have on the environment.[8] (*See* Mem. Supp. Pl. ***127** NAHB's Mot. Summ. J. 17–32 ("NAHB's Mem.").) The Corps argues that the NWPs and GCs issued by the Corps do not violate the APA in their regionalized analysis of the "minimal adverse environmental effects" and that the Corps did not violate the APA by not defining the term "minimal adverse environmental effects." (*See* Corps' Mem. 29–30, 37–39.) For the following reasons, the Court agrees with the Corps that the NWPs and GCs do not violate the provisions of the APA.[9]

8 Plaintiffs contend that defendant fundamentally misconstrued the scope of its regulatory authority under the CWA, 33 U.S.C. § 1251 *et seq.*, as established in *Solid Waste Agency of Northern Cook County v. U.S. Army Corps of Engineers* ("*SWANCC* "), 531 U.S. 159, 121 S.Ct. 675, 148 L.Ed.2d 576 (2001), and that this jurisdictional misconstruction undermines defendant's actions regarding the issuance of NWPs. Specifically, plaintiff NAHB contends that in assessing the effects of fills authorized under NWP 26, defendant improperly considered the effects of fills in isolated waters that are beyond the defendant's jurisdiction (NAHB's Mem. 13), and plaintiff NSSGA argues that defendant's issuance of Replacement Permits is in "direct conflict" with the *SWANCC* decision because they seek to regulate discharges into "ephemeral streams" that it considers beyond defendant's jurisdiction to regulate (NSSGA's Mem. 13). Accordingly, plaintiffs demand that "[t]he Corps' [permit] decisions must be vacated, the status quo restored, and this action remanded to the Corps to reconsider in light of *SWANCC*." (NAHB's Mem. 17.)

The CWA explicitly provides that "the objective of this chapter is to restore and maintain the chemical, physical, and biological integrity of the Nation's waters." 33 U.S.C. § 1251(a). The Act provides that the Army Corps of Engineers may issue permits that "will have only minimal cumulative adverse effect on the environment." 33. U.S.C. § 1344(e)(1). Defendant has correctly noted throughout its pleadings that "its analysis of cumulative adverse impacts did not depend on nationwide mathematical calculation of the jurisdictional waters covered by the NWPs." (*See, e.g.*, Corps' Supp. Mem. in Support of Defs.' Mot Summ. J. 12 ("Corps' Suppl. Mem.").) The language of CWA Section 1344(e)(1) is broad, and no language limits the "environment" on which cumulative adverse effects are to be assessed.

Moreover, while plaintiffs are correct that the Supreme Court's decision in *SWANCC* makes clear that the Corps' regulatory jurisdiction is limited to "waters of the United States," this holding is irrelevant to the instant issue. As defendant rightly notes, a body of water does not become a "water of the U.S." and come within its regulatory jurisdiction because of an NWP; rather, the NWP simply specifies the permit criteria for bodies of water that are already within the Corps' regulatory jurisdiction.

Accordingly, plaintiff NAHB's contention that defendant incorrectly considered the adverse effects on the environment as a whole—including areas beyond its regulatory jurisdiction—when issuing the Replacement Permits is without merit. Plaintiff NSSGA's contention that defendant seeks to regulate waters outside of its jurisdiction by the terms of its Replacement Permits must similarly be rejected.

9 It should be noted that in a letter to the Corps, NAHB conceded that the "NWP program ... results in only minimal adverse environmental impacts." (NAHB Suppl. Mem., Ex. 2 at 12.)

[6] A court must set aside an agency decision if it lacks "substantial evidence" in the record to support the conclusion. 5 U.S.C. § 706(2)(E); *A.T. & T. Corp. v. FCC*, 86 F.3d 242, 247 (D.C.Cir.1996). In deciding if there is "substantial evidence" in the record to support an agency's position, the Court's analysis is limited to determining whether the agency's decision was "rational and based on consideration of the relevant factors." *FCC v. Nat'l Citizens Comm. for Broad.*, 436 U.S. 775, 803, 98 S.Ct. 2096, 56 L.Ed.2d 697 (1978). That said, an agency must provide a "clear and coherent explanation" for its ruling. *Cf. Tripoli Rocketry Ass'n, v. ATF*, 437 F.3d 75, 81 (D.C.Cir.2006). Section 706 of the APA requires this Court to consider the administrative record in its entirety to determine the factors the agency considered in making its decision. 5 U.S.C. § 706; *see Citizens to Pres. Overton Park, Inc. v. Volpe*, 401 U.S. 402, 419–20, 91 S.Ct. 814, 28 L.Ed.2d 136 (1971). "To survive review under the 'arbitrary and capricious' standard, an agency must 'examine the relevant data and articulate a satisfactory explanation for its action including a rational connection between the facts found and the choice made.' " *PPL Wallingford Energy LLC v. FERC*, 419 F.3d 1194, 1198 (D.C.Cir.2005) (citing *State* ***128** *Farm*, 463 U.S. at 43, 103 S.Ct. 2856) (internal quotation marks omitted). An agency must respond meaningfully to objections raised and those responses must be facially legitimate; if it fails to do so the Court will render its decision arbitrary and capricious. *Id.*; *see also Public Serv. Comm'n v. FERC*, 397 F.3d 1004, 1008 (D.C.Cir.2005); *Canadian Ass'n of Petroleum Producers v. FERC*, 254 F.3d 289, 299 (D.C.Cir.2001). However, the agency's decision need not be a "model of analytical precision," *Dickson v. Sec'y of Def.*, 68 F.3d 1396, 1404 (D.C.Cir.1995), and the agency's decision will be upheld even if it is not ideally clear as long as the "agency's path may be reasonably be discerned," *id.* (internal quotation marks omitted) (quoting *Bowman Transp., Inc. v. Arkansas–Best Motor Freight Sys.*, 419

U.S. 281, 286, 95 S.Ct. 438, 42 L.Ed.2d 447 (1974)). The agency's decision must contain " 'a rational connection between the facts found and the choice made,' " *Motor Vehicle Mfrs.*, 463 U.S. at 43, 103 S.Ct. 2856 (quoting *Burlington Truck v. U.S.*, 371 U.S. 156, 168, 83 S.Ct. 239, 9 L.Ed.2d 207 (1962)); yet, if the decision "merely parrots the language of the statute without providing an account of how it reached its results," then the agency has not provided an adequate explanation for its actions, *Dickson*, 68 F.3d at 1405.

The CWA was enacted in order to "restore and maintain the chemical, physical, and biological integrity of the Nation's waters." 33 U.S.C. § 1251(a). In passing the Act, Congress provided the Corps the ability to issue general, and individual permits, to parties to discharge pollutants, such as dredged or fill material, into navigable waters of the United States. *Id.* § 1344. However, the Corps can only issue general permits that "will cause only minimal adverse environmental effects when performed separately" or cumulatively. *Id.* § 1344(e)(1).

In the Corps' March 9, 2000 Final Notice that issued five new NWPs and two new GCs and modified six NWPs and nine GCs which were to replace NWP 26 when it expired, the Corps made it clear that it appreciated:

> that the terms and conditions of the new and modified NWPs may cause some activities with minimal adverse effects on the aquatic environment to be subject to the individual permit process. It is important to note that aquatic resource functions and values differ greatly across the country. When developing NWPs that have national applicability, there will be many parts of the country where the terms and limits of the NWPs will not authorize some activities that have minimal adverse effects on the aquatic environment.

65 Fed.Reg. at 12,820. Thus, it is clear from this statement that the Corps purposefully set the NWPs at a low level in order to err on the side of protecting the environment when allowing the discharge of pollutants into the navigable waters of the United States. This approach, although, disagreeable to the plaintiffs, is not only natural, but reasonable in light of the industrial permit options available to those whose activities will have minimal adverse effects on the environment.

Indeed, in the January 15, 2002 Final Notice that re-issued all existing NWPs and GCs, modified some definitions, and issued one new GC, the Corps specifically stated as a part of its reasoning that because aquatic resources and values differ so greatly across the country, "minimal effects determinations for proposed NWP activities should be made at the local level by district engineers." 67 Fed.Reg. at 2027–28. Thus, the Corps, in essence, concluded that questions necessitating technical ***129** certainty should be developed at the local, not national, level.

By setting a baseline that is low and more protective of these waters against the discharge of pollutants, the Corps chose to protect the waters of the United States that are more sensitive to discharged pollutants than waters that are less affected by a similar discharge. This "path" is reasonably discernable from the final notices the Corps has issued. *See Dickson*, 68 F.3d at 1404; 65 Fed.Reg. 12,818 (Mar. 9, 2000); 67 Fed.Reg.2020 (Jan. 15, 2002). Indeed, if the national baseline is not protective enough for certain areas, regional district engineers can "add special conditions to the NWP authorization to ensure that the activity results in no more than minimal adverse environmental effects." 67 Fed.Reg. at 2027; *see* 65 Fed.Reg. at 12, 821.

While the Corps acknowledges that the lower acreage limits and pre-construction notification thresholds may require "certain activities that were previously authorized by NWPs" to "require individual permits, and that it takes more time to authorize those activities," 67 Fed.Reg. at 2022, the limits and thresholds, as well as all the new or modified NWPs, were "necessary to ensure compliance with section 404(e) of the Clean Water Act,"[10] *id.* The decision documents for each of the NWPs, which were issued on January 4, 2002, and are part of the administrative record, discuss the impacts that the activities governed by these NWPs and GCs will have on the environment and the associated aquatic life. (*See, e.g.*, Suppl. A.R. 42, Decision Document Nationwide Permit 19, Civ. Act. No. 00–379, Dkt. # 89.) The different activities authorized by the NWPs and the different conditions of the aquatic environment in the United States require rules that can account for the complexities of protecting the diverse aquatic environment of the United

States. *See* 65 Fed.Reg. at 12,819 ("Some complexity is unavoidable because different activities in waters of the United States do not have the same effects on the aquatic environment and each NWP must have different conditions to address those dissimilar impacts.").

10 Plaintiffs argue that the Corps issuance of the NWPs is contrary to the intent of Congress to create a "streamlined" system of general permits as expressed in Section 404(e) of the CWA. (NAHB's Mem. 24–27.) The Corps counters that the CWA does not "set a 'streamlining' standard that the Corps must meet" (Corps' Mem. 43), and that "[s]treamlining is not a statutory factor upon which to measure whether the NWPs are arbitrary or capricious or contrary to law," *id.* at 42–43. Section 404(e)(1) of the CWA, under which the NWPs and GCs are promulgated, states that the Secretary of the Army, acting through the Chief of Engineers, may issue NWPs "if the Secretary determines that the activities in such category are similar in nature, will cause only minimal adverse environmental effects when performed separately, and will have only minimal cumulative adverse effect on the environment." 33 U.S.C. § 1344(e)(1). Nowhere does the statute state that the Secretary must enact NWPs that "streamline" the "authorization of minimal effects projects." (NAHB's Mem. 24.)

While efficiency in the granting of permits for projects is a corollary of the issuance of NWPs, efficiency does not drive the creation of the NWPs—protecting the environment does. *See* 67 Fed.Reg. at 2022. The Corps issues the NWPs in order to create a baseline of activity that is allowed without one having to undergo the individual permitting process, and in doing so, the permits only allow activities that result in "minimal adverse environmental effects." *See id.* When working to protect the environment on a national level through the issuance of the NWPs, the effects that the permitted activities have on the environment is paramount to any efficiency that may result to the Corps or the permit seekers. Therefore, plaintiffs' argument fails.

[7] A review of the record makes it clear that the Corps has adequately explained ***130** its reasoning behind the issuance and re-issuance of the NWPs and GCs.[11] While the Corps' reasoning may be unnecessarily lengthy, it is reasonable, supported by the facts, and its explanation clearly and adequately lays out the "path" of the Corps' logic and that logic has been adequately explained. *See Motor Vehicle Mfrs.*, 463 U.S. at 43, 103 S.Ct. 2856 (quoting *Bowman Transp., Inc.*, 419 U.S. at 286, 95 S.Ct. 438); *Dickson*, 68 F.3d at 1404 (quoting *Bowman Transp., Inc.*, 419 U.S. at 286, 95 S.Ct. 438) Accordingly, this Court finds that the Corps did not act arbitrarily or capriciously, or abuse its discretion, in performing a regionalized analysis of the "minimal adverse environmental effects" the NWPs would have on the environment.[12]

11 While plaintiffs point to the fact that the Corps repeats the phrase "minimal adverse environmental effects" throughout the Final Notices as an indication that the Corps is only parroting the language of the statute as the core of its reasoning in the issuance of the NWPs and GCs, *see Dickson*, 68 F.3d at 1405, the Corps has adequately explained its decision to promulgate the NWPs and GCs, as they are necessary to protect those parts of the environment that are most sensitive to the discharge of pollutants, *see* 65 Fed.Reg. at 12,819–20 and 67 Fed.Reg. at 2022.

12 Plaintiffs additionally ask the Court "to enjoin the expiration of NWP 26 and reinstate its terms." (NSSGA's Mem. 26.) As correctly noted by Intervenor–Defendants NRDC and Sierra Club, the Court lacks the authority to provide this remedy. (*See* Def.-Intervenors NRDC's & Sierra Club's Post–Arg. Suppl. Mem. Supp. Defs.' Cross–Mots. Summ. J. 2.) As a threshold matter, as Plaintiff NAHB acknowledges in its Motion for Summary Judgment, NWP 26 has *already* expired (NAHB's Mem. 34), and an expired permit is "null and void," 33 C.F.R. § 330.6(b), and, therefore, cannot be reinstated. Second, the CWA Section 404(e)(2) explicitly provides that "[n]o general permit issued under this subsection shall be for a period of more than five years after the date of its issuance." 33 U.S.C. § 1344(e)(2). Again, because NWP 26 was issued more than five years ago, it has expired. Because the CWA gives the authority to issue permits to the Corps and not the courts, § 1344(e)(1), this Court lacks the power to reinstate NWP 26. Finally, the CWA provides that the Corps "may" issue general permits. *Id.* Notably, the statute does not say the Corps "shall" issue general permits. Thus, issuance of general permits is a discretionary decision of the Corps. *See id.* Moreover, this decision is to be made only after the Corps "determines" that the activities authorized by the permit are similar in nature and will have only a "minimal adverse environmental effect." *Id.* The Corps has not made such a determination with regard to a re-issuance of NWP 26, and this Court is

ill-equipped to do so. Accordingly, this Court denies plaintiffs' request to enjoin the expiration of NWP 26 and reinstate its terms.

[8] Plaintiffs also claim, in essence, that the Corps' failure to define the term "minimal adverse environmental effect" is arbitrary, capricious, and an abuse of discretion. (NAHB's Mem. 19–20; Pls.' Joint Suppl. Filing Supp. Pls.' Mots. Summ. J. 2–7.) Conversely, the Corps claims that it is not only not required to define this term, but that such a definition is impossible to determine on a national level due to the diversity of the aquatic environments of the waters of the United States. (Corps' Mem. 37–39; Def.'s Post–Arg. Br. 1–5.) The Court agrees with the Corps. *See* 65 Fed.Reg. at 12,862–63. What is a minimally adverse environmental impact in Arizona, for example, will not be the same as the effect on the bayous of Louisiana. Thus, the Corps has reasonably articulated its reasoning behind the promulgation of the NWPs and the GCs and that reasoning is supported by the record. Therefore, the Corps is not required to define the term "minimal adverse environmental effect," and, thus, did not act arbitrarily or capriciously or contrary to law. [13]

13 Plaintiff NSSGA contends that the certain NWPs exceed defendant's jurisdiction because they seek to regulate "excavation" activities, and defendant's regulatory jurisdiction is limited to the discharge of "pollutants" and "dredged or fill material into the navigable waters at specified disposal sites." 33 U.S.C. §§ 1342(a), 1344(a). Plaintiff correctly notes these limitations on defendant's regulatory jurisdiction and that not all excavations result in a discharge that defendant may regulate. (*See* Pl. NSSGA's Mot. Summ. J. 17–20.) However, the NWPs address only those activities that result in a discharge that defendant *may properly regulate*. *See* 67 Fed.Reg. at 2020. Thus, the NWPs did not exceed defendant's jurisdiction, and plaintiffs claim must therefore fail.

131 *III. CWA Section 404(e) Allows the Corps to Decide on a Reasonable Basis the Particular Aspects for the NWPs and the GCs.

[9] Plaintiffs claim that the Corps exceeded its statutory authority by issuing NWPs and GCs with more restrictive regulations than had previously been allowed under NWP 26, or were initially under consideration by the Corps during the notice and opportunity to comment period prior to the issuance, and re-issuance, of the NWPs and GCs. (NAHB's Mem. 25–31; NSSGA's Mem. 13–41.) The Corps asserts that it did not act arbitrarily, capriciously, or contrary to law when it set a national baseline of what would constitute "minimal adverse environmental effects" for the various activities and projects that would be allowed to proceed under the NWPs or GCs. *See supra* 15–22. For the reasons set forth below, the Court agrees with the Corps. [14]

14 Plaintiffs additionally argue that the Corps violated Section 404(e)(2) of the CWA by revoking or modifying NWPs without expressly finding that the NWPs have an adverse impact on the environment or that the "activities are more appropriately authorized by individual permits." (*See* NAHB Mem. 32–34; *see also* NAHB's Suppl. Mem. 14.) The Corps argues that NWP 26 expired and, therefore, was not revoked or modified, and that such findings were made when the replacement NWPs were issued. (Corps' Mem. 44–48.) Section 404(e)(2) of the CWA states that an NWP "may be revoked or modified by the Secretary if ... the Secretary determines that the activities authorized by such general permit [NWP] have an adverse impact on the environment or such activities are more appropriately authorized by individual permits." 33 U.S.C. § 1344(e)(2).

First, NAHB has admitted that NWP 26 has already expired. (NAHB's Mem. 34.) Moreover, because NWP 26 was issued over five years before NAHB's Supplemental Motion for Summary Judgment, the permit had expired, *see* 33 U.S.C. § 1344(e)(2), and, accordingly, no finding by the Corps was necessary. Even if at the time the Corps issued the new NWPs and modified several NWPs, NWP 26 was still active, the Corps made the requisite finding necessary under Section 404(e)(2) in its final notices, as it explained that the new or modified NWPs were necessary to ensure that only "minimal adverse environmental effects" resulted from the discharge of pollutants. *See* 65 Fed.Reg. at 12,820; *see also* 65 Fed.Reg. at 12,819 ("These new restrictions on use of the NWPs will substantially increase the protection of the Nation's aquatic environment," and "the new and modified NWPs are conditioned to ensure that only those activities that have minimal adverse effects on the aquatic environment are authorized by these permits"); *see also* 67 Fed.Reg. at 2028. It is clear from the Corps explanation that if NWP 26 was still active, it was revoked because of its adverse impact on the environment and because the Corps has determined that it would be more protective of the environment to require individual permitting